

MAG 208

Water Quality Management Plan Amendment Application

November 2004

Prepared for:
Palo Verde Road Wastewater Treatment Plant
Town of Buckeye
100 North Apache
Buckeye, Arizona 85326
Phone: (623) 386-4691
Fax: (623) 386-7832



Engineering Firm:
RBF Consulting
Engineer: Brandon Squire, P.E.
16605 North 28th Avenue, Suite 100
Phoenix, Arizona 85053-7550
Phone: (602) 467-2200
Fax: (602) 467-2201

RBF JN: 45-101318



TOWN OF BUCKEYE

June 9, 2004

Ms. Lindy Bauer, Environmental Program Coordinator
Maricopa Association of Governments
302 North 1st Avenue, Suite 300
Phoenix, AZ 85003

Subject: MAG 208 AMENDMENT – BUCKEYE, ARIZONA

Dear Ms. Bauer:

The Town of Buckeye is submitting a 208 Amendment for the Buckeye Planning Area. In accordance with the MAG 208 Water Quality Management Plan, we are officially requesting that you initiate the amendment process to consider the Palo Verde Road Wastewater Treatment Plant and the area that it would serve.

We look forward to working with you and appreciate your assistance to facilitate the MAG approval process for this 208 Amendment.

Sincerely,



Carroll Reynolds, P.E.
Public Works Director/Interim Town Manager

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Appendix A

Palo Verde Road WWTP Amendment Map
Map of Existing Well Locations within Proposed Service Area

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Proposed Construction Phases Report

208 AMENDMENT CHECKLIST

Section 208 Clean Water Act

40 CFR Part 130.6

REQUIREMENT	PROVIDE BRIEF SUMMARY ON HOW REQUIREMENTS ARE ADDRESSED	ADDRESSED ON PAGE:
<u>AUTHORITY</u>		
Proposed Designated Management Agency (DMA) shall self-certify that it has the authorities required by Section 208(c)(2) of the Clean Water Act to implement the plan for its proposed planning and service areas. Self-certification shall be in the form of a legal opinion by the DMA or entity attorney.	MAG is the Designated Planning Agency that has the authority as required in CWA 208(a)(2)(B).	2
<u>20-YEAR NEEDS</u>		
Clearly describe the existing wastewater (WWT) treatment facilities:	The Town of Buckeye operates a wastewater treatment plant within the Town of Buckeye planning area. Two other plants are currently in operation, including the Sundance WWTP and the Lewis Prison Complex WWTP. No existing facilities are located within the proposed service area. The proposed service area is within the Town's planning area.	2
- Describe existing WWT facilities.		
- Show WWT certified and service areas for private utilities and sanitary district boundaries if appropriate.	There are no private utilities or sanitary districts within the planned area for this facility.	6
Clearly describe alternatives and the recommended WWT plan:		
- Provide POPTAC population estimates (or (COG-approved estimates only where POPTAC not available) over 20-year period.	The Town of Buckeye is projected to grow to 82,384 people by 2020. The service area is projected to include 13,910 residential units at ultimate build out.	3
- Provide wastewater flow estimates over the 20-year planning period.	Estimated flows range from 0.5 MGD at Phase 1A to 10.2 MGD at ultimate build-out.	4
- Illustrate the WWT planning and service areas.	The service area for the proposed Palo Verde Road WWTP is located within the Town of Buckeye Planning Area. The service area includes areas bounded by Interstate-10, Bruner Road, Van Buren Street, Wilson Road, Turner Road, Johnson Road, and the ½-mile road between Broadway Road and Southern Avenue.	Appendix A
- Describe the type and capacity of the recommended WWT plant.	A treatment facility with a sequencing batch reactor (SBR) process will provide screening, BOD removal, secondary clarification, nitrification and denitrification, tertiary filtration, UV disinfection, either aerobic or anaerobic sludge digestion, sludge dewatering, sludge disposal strategy, and flow equalization. The plant will be equipped with odor control, which includes covers and odor scrubbing equipment. The ultimate capacity of the facility will be 10.2 MGD.	4
- Identify water quality problems, consider alternative control measures, and recommend solution for implementation.	No water quality problems are anticipated. Effluent will be A+ quality. Effluent will meet all limits established by the NPDES Permit, reuse permit, and recharge permit.	5
- If private WWT utilities with certified areas are within the proposed regional service area; define who (municipal or private utility) serves what area and when. Identify whose sewer lines can be approved in what areas and when?	There are no private utilities within the proposed service area.	6
- Describe method of effluent disposal and reuse sites (if appropriate).	Effluent from the Palo Verde Road WWTP will be disposed of in four manners: 1) direct reuse for irrigation of green areas, 2) recharge of groundwater through means of recharge basins or wells, 3) reuse for irrigation in the Buckeye Water Conservation and Drainage District Canal (BID), and 4) discharge to Hassayampa River.	5
- If Sanitary Districts are within a proposed planning or service area, describe who serves the Sanitary Districts and when.	There are no sanitary districts within the proposed planning or service areas.	6
- Describe ownership of land proposed for plant sites and reuse areas.	The land for the plant is owned by Youngker Farms Limited Partners. Westwind Properties and Newport Development will oversee and fund construction of the WWTP. Once construction of the facilities is complete, the Town of Buckeye will own the facility. The Town of Buckeye will own all recharge areas. Reuse areas will be owned by the Town, school districts, various homeowners' associations, and other private entities.	2

- Address time frames in the development of the treatment works.	The project will be divided up into phases. Phase 1A of the Project will have a treatment capacity of 0.5 MGD and construction is anticipated to be complete between March and September of 2005. Design of each additional phase must begin when 70% of the plant capacity has been reached as determined from recorded properties to be served by the plant or measured flow in the collection system. Construction of each phase must begin when 80% of the plant capacity has been reached as determined from recorded properties to be served by the plant or measured flow in the collection system. The ultimate capacity of the plant will be 10.2 MGD.	8
- Address financial constraints in the development of the treatment works.	Westwind Properties and Newport Development will provide initial capital necessary to fund construction of the WWTP. Upon completion of the facility, ownership will be transferred to the Town of Buckeye, which will oversee and fund the plant's operations and maintenance.	9
- Describe how discharges will comply with EPA municipal and industrial stormwater discharge regulations (Section 405, CWA).	All storm water will be contained onsite and there will be no offsite storm water discharge.	6
- Describe how open areas & recreational opportunities will result from improved water quality and how those will be used.	Palo Verde Road WWTP effluent will be a primary irrigation source for open areas. The reuse of effluent will safely enhance the parks and open space while minimizing the use of groundwater for irrigation. Effluent will be A+ quality.	5
- Describe potential use of lands associated with treatment works and increased access to water-based recreation, if applicable.	Not applicable.	Not applicable.
REGULATIONS		
- Describe types of permits needed, including NPDES, APP and reuse.	Permits required are NPDES, APP, reuse, recharge, air quality, architectural, building, approval to construct, approval of construction, sludge disposal, and sludge hauling.	7
- Describe restrictions on NPDES permits, if needed, for discharge and sludge disposal.	The quality of the effluent will meet requirements of the Clean Water Act.	5
- Provide documentation of communication with ADEQ Permitting Section 30 to 60 days prior to public hearing regarding the need for specific permits.	The required permits from ADEQ and ADWR will be obtained in the Town of Buckeye's name.	7
- Describe pretreatment requirements and method of adherence to requirements (Section 208 (b)(2)(D), CWA).	Future industrial development within the airport as well as in the surrounding vicinity is likely. The Town of Buckeye and ADEQ will assess future industrial users and their respective manufacturing processes on an individual basis with respect to pretreatment requirements. Each perspective industrial user will be required to comply with requirements set forth by the Town of Buckeye and ADEQ.	7
- Identify, if appropriate, specific pollutants that will be produced from excavations and procedures that will protect ground and surface water quality (Section 208(b)(2)(K) and Section 304, CWA).	Not applicable.	Not applicable.
- Describe alternatives and recommendation in the disposition of sludge generated. (Section 405 CWA)	Sludge will be dewatered and either disposed of at an approved landfill or applied to approved agricultural land. Sludge hauler and sludge disposal agreements will be obtained. Sludge will be of such a quality that it may be used for agricultural purposes.	8
- Define any non-point issues related to the proposed facility and outline procedures to control them.	Not applicable.	Not applicable.
- Describe process to handle all mining runoff, orphan sites and underground pollutants, if applicable.	Not applicable.	Not applicable.
- If mining related, define where collection of pollutants has occurred, and what procedures are going to be initiated to contain contaminated areas.	Not applicable.	Not applicable.
- If mining related, define what specialized procedures will be initiated for orphan sites, if applicable.	Not applicable.	Not applicable.
CONSTRUCTION		
Define construction priorities and time schedules for initiation and completion.	The project will be divided into phases. Phase 1A of the project will have a treatment capacity of 0.5 MGD and construction is anticipated to be complete between March and September of 2005. Design of each additional phase must begin when 70% of the plant capacity has been reached as determined from recorded properties to be served by the plant or measured flow in the collection system. Construction of each phase must begin when 80% of the plant capacity has been reached as determined from recorded properties to be served by the plant or measured flow in the collection system. The ultimate capacity of the plant will be 10.2 MGD.	8

Identify agencies who will construct, operate and maintain the facilities and otherwise carry out the plan.	Westwind Properties and Newport Development will bid for a construction firm to design and build the Palo Verde Road WWTP. Prior to operation, the Town of Buckeye will obtain complete ownership of the facility and will oversee operation and maintenance services for this facility.	8
Identify construction activity-related sources of pollution and set forth procedures and methods to control, to the extent feasible, such sources.	Pollutants associated with construction activities are anticipated to be limited to solid waste, inert materials, and residual construction materials all of which will be properly disposed of after construction activities are complete.	8
FINANCING AND OTHER MEASURES NECESSARY TO CARRY OUT THE PLAN		
- If plan proposes to take over certificated private utility, describe how, when and financing will be managed.	Not applicable.	Not applicable.
- Describe any significant measure necessary to carry out the plan, e.g., institutional, financial, economic, etc.	The phasing of the expansion will depend upon the increase in population and commercial development in the Out Parcels and resultant wastewater flows.	10
- Describe proposed methods(s) of community financing.	Westwind Properties and Newport Development will provide the funding necessary to design and build the WWTP up to 3.3 MGD. Upon completion, ownership of the WWTP will be transferred to the Town of Buckeye.	9
- Provide financial information to assure DMA has financial capability to operate and maintain wastewater system over its useful life.	The Town of Buckeye has the financial capacity to operate the facility.	Appendix B
- Provide a timeline outlining period of time necessary for carrying out plan implementation.	Construction for the initial phase of the facility is anticipated to be complete between March and September of 2005. The additional phases will be completed as dictated by the capacity of the plant.	10
- Provide financial information indicating the method and measures necessary to achieve project financing. (Section 201 CWA or Section 604 may apply.)	See financial statements in Appendix B.	Appendix B
IMPLEMENTABILITY		
Describe impacts and implementability of Plan:		
- Describe impacts on existing wastewater (WW) facilities, e.g., Sanitary district, infrastructure/facilities and certificated areas.	No existing facilities in the proposed planning or services areas.	6
- Describe how and when existing package plants will be connected to a regional system.	Not applicable.	Not applicable.
- Describe the impact on communities and businesses affected by the plan.	There will be no impacts on communities or businesses anticipated.	10
- If a municipal wastewater (WWT) system is proposed, describe how WWT service will be provided until the municipal system is completed: i.e. will package plants and septic systems be allowed and under what circumstances. (Interim services)	Not applicable.	Not applicable.
PUBLIC PARTICIPATION		
- Submit copy of mailing list used to notify the public of the public hearing on the 208 amendment. (40 CFR, Chapter 1, Part 25.5)	All public notifications will be satisfied through MAG.	11
- List location where documents are available for review at least 30 days before public hearing.	All public notifications will be satisfied through MAG.	11
- Submit copy of the public notice of the public hearing as well as an official affidavit of publication from the area newspaper. Clearly show the announcement appeared in the newspaper at least 45 days before the hearing.	All public notifications will be satisfied through MAG.	11
- Submit affidavit of publication for official newspaper publication.	All public notifications will be satisfied through MAG.	11
- Submit responsiveness summary for public hearing.	All public notifications will be satisfied through MAG.	11

1 Executive Summary

The Maricopa Association of Governments (MAG) is the Designated Planning Agency with the authority, required by Section 208 (a)(2)(B) of the Clean Water Act, to amend the Water Quality Plan for the Maricopa County Planning Area. The purpose of this application is to request an amendment to the existing MAG 208 Water Quality Management Plan (MAG 208 Plan) to accommodate the proposed 10.2 MGD Palo Verde Road Wastewater Treatment Plant (WWTP), effluent reuse at proposed open areas, and recharge in a proposed recharge basin. The recharge to a proposed groundwater recharge facility located within the planning area will vary on the viability and reliability of such a system and the daily and seasonal basis, depending on irrigation demands from public and private users. In the case that groundwater recharge is not viable, reclaimed effluent in excess of direct reuse demands will be diverted to the BID canal and/or the Hassayampa River. The service area for this plant is located within the Buckeye Planning Area.

Westwind Properties and Newport Development will oversee construction of the WWTP. They will also provide the initial capital necessary to fund the design and construction of the WWTP. Once construction is complete, ownership of the WWTP will be transferred to the Town of Buckeye who will subsequently oversee maintenance and operation of the plant. The Town of Buckeye will recover costs incurred from construction of the plant. Sources of wastewater will be domestic, commercial, and possibly industrial. The Town of Buckeye and Arizona Department of Environmental Quality will assess future industrial users and their respective manufacturing processes on an individual basis. Each prospective industrial user will be required to be in compliance with all pretreatment requirements dictated by the Town of Buckeye and all federal pretreatment requirements as provided in 40 CFR Part 403 and enforced by Arizona Department of Environmental Quality.

This Clean Water Act (CWA) 208 Amendment application contains the required information on the proposed construction and operation of the Palo Verde Road WWTP. The volumes treated and discharged will increase over time as the capacity of the plant is increased. Phase 1A of the proposed WWTP facility is scheduled for completion between March and September of 2005 with a capacity of 0.5 MGD. Future expansions are anticipated, bringing the ultimate capacity to 10.2 MGD. Design of these improvements will begin when 70% of the plant capacity has been reached as calculated by the number of platted properties that the plant will serve or measured flows from the collection system and construction will begin when 80% of the plant capacity has been reached.

The CWA Section 208 Checklist on the preceding pages provides a summary of the amendment application requirements and the proposed improvements addressing these issues.

2 Authority

The Maricopa Association of Governments (MAG) is the Designated Planning Agency with the authority required by Section 208 (a)(2)(B) of the Clean Water Act to amend the Water Quality Plan for the Maricopa County Planning Area. MAG has authority to implement the plan for the proposed planning and services areas as outlined in this application.

The proposed facility is to be located within the planning area for the Town of Buckeye.

3 20-Year Needs

3.1 Description of the Existing Wastewater Treatment Plant (WWTP)

The proposed WWTP on Palo Verde Road and the service area pertaining to its operation will be located within the planning area for the Town of Buckeye. The proposed project would be located within a 3-mile radius of the Maricopa County unincorporated area.

Three WWTPs are currently in operation within the planning area for the Town of Buckeye. The Town of Buckeye operates a 0.6 MGD WWTP located approximately 4.5 miles to the southeast of the proposed WWTP on Palo Verde Road. A proposed sewer trunk line comprised of 15-inch and 18-inch pipe that feeds into the Town of Buckeye WWTP will be located approximately 2 miles east of the eastern border of the proposed service area. This sewer trunk line is shown on the Palo Verde Road WWTP Amendment Map in Appendix A. The Rooks Road sewer alignment is currently under construction and both the depth and capacity constraints associated with this line preclude the option to convey wastewater flows from the proposed service area through the Rooks Road alignment. The Town's decision to allow the proposed Palo Verde Road WWTP service area was also based on the limited capacity in the existing sewer line in Beloit Road.

The second WWTP located within the planning area for the Town of Buckeye is the Lewis Prison Complex WWTP located on SR-85 approximately 14 miles south of the proposed Palo Verde WWTP. The third WWTP located within the planning area for the Town of Buckeye is the Sundance WWTP located approximately 7.5 miles to the northeast of the proposed WWTP on Palo Verde Road.

Town of Buckeye Wastewater Master Plan, March 2000, prepared by David Evans and Associates (DEA), indicates numerous expansions to the existing collection system and WWTP. Such improvements do not lie within the proposed Palo Verde WWTP service area.

3.2 Description of the Proposed Wastewater Treatment Plan

3.2.1 Site Location and Property Ownership

The proposed location of the Palo Verde WWTP is within the northwestern quarter of Section 28 in Township 1 North, Range 4 West of the Gila and Salt River Base and Meridian, Town of Buckeye, Maricopa County, Arizona (see Palo Verde WWTP Amendment Map, Appendix A). The service area includes areas bounded by

Interstate-10, Bruner Road, Van Buren Street, Wilson Road, Turner Road, Johnson Road, and the ½-mile road between Broadway Road and Southern Avenue. The facility location and service area are located within the Buckeye Planning Area.

Currently the property is owned by Youngker Farms Limited Partners. Once construction is complete, the Town of Buckeye will own the WWTP and associated property. Effluent reuse areas will be owned privately and effluent recharge areas will be owned by the Town of Buckeye.

Setback requirements per AAC R18-9 will be met as shown Figure 1 of Appendix D.

3.2.2 Topographic Conditions

The existing ground within the proposed Palo Verde WWTP service area slopes generally to the south at an approximate slope of 0.01 ft/ft. The proposed service area consists of undeveloped desert landscape, dairies, retired agricultural land, and the Town of Buckeye Airport.

The following major roadways intersect the proposed service area: I-10, Van Buren Street, Sun Valley Parkway, Turner Road, Wilson Avenue, Palo Verde Road, Bruner Road, Johnson Road, Lower Buckeye Road and Broadway Road. In addition, the Buckeye Airport is centrally located within the proposed Palo Verde WWTP service area.

3.2.3 Population Estimates

The Department Economic Security (DES) Population Statistics Unit prepares official population estimates and projections for the State of Arizona. The DES projects the population of Buckeye for the 20-year planning period to reach 82,384. It is anticipated that the WWTP will accommodate a portion of this population.

The Palo Verde WWTP will have a limited service area as shown in the Palo Verde Road WWTP Amendment Map in Appendix A. Population projections are based on the Westwind Community Master Plan and the SilverRock Community Master Plan. The Westwind Master Planned Community is proposing to add 3,200 Equivalent Dwelling Units (EDUs) to the service area at build-out. The SilverRock Master Planned Community is proposing to add 5,500 EDUs to the service area at build-out. An additional 5,210 EDU's will be included in the service area from residential parcels outside the Westwind and SilverRock communities but located within the Palo Verde Road WWTP service area. The Westwind development is proposing to add an additional 170 EDUs from commercial development, and 333 EDUs from schools. The SilverRock development is proposing to add an additional 1,313 EDUs from commercial development, and 250 EDUs from schools. There will also be 16,460 EDUs from commercial development from parcels outside the Westwind Master Planned Community. In addition to such future commercial development, commercial and industrial developments that are anticipated to expand the current facilities at the airport site are projected to contribute 1,540 EDUs to the service area of the proposed WWTP. This estimate is based on the premise that half of the 615-acre airport site will be developed for general commerce and possibly for industrial applications. The remaining half is occupied by runway space.

3.2.4 Estimated Wastewater Flow

The proposed service area for the Palo Verde Road WWTP is located within the Buckeye planning area. The projected wastewater flows from the Westwind and SilverRock developments are outlined in their respective wastewater master plans. Table 3.1 summarizes the anticipated flows.

Table 3.1 Flow Summary for the area serviced by the proposed Palo Verde Road WWTP

Description	Equivalent Dwelling Units	Flow (gal/unit/day)	Average Daily Flow (gpd)
Westwind Residential	3,200	300	960,000
Westwind Commercial	170	300	51,000
Westwind School	333	300	99,900
Westwind Subtotal	3,703	NA	1,110,900
SilverRock Residential	5,500	300	1,650,000
SilverRock Commercial	1,313	300	393,900
SilverRock School	250	300	75,000
Silver Rock Subtotal	7,063	NA	2,118,900
Outside Parcels Residential	5,210	300	1,563,000
Outside Parcels Commercial	16,460	300	4,938,000
Outside Parcels Airport	1,540	300	462,000
Total	33,976	NA	10,192,800

3.2.5 WWTP Description

The Palo Verde Road WWTP will consist of a multi-phased Sequential Batch Reactor (SBR) system with average flow capacity of 0.5 MGD for the initial phase (Phase 1A) of plant construction. Further phasing is anticipated to proceed such that Phase 1 at completion will provide 1.0 MGD of treatment capacity, Phase 2 will provide 2.0 MGD, Phase 3 will provide 4.0 MGD, Phase 4 will provide 8.0 MGD, and ultimate plant capacity at full build-out will provide 10.2 MGD of treatment capacity, based on average day generation. The treatment process will consist of screening, secondary biological treatment using the activated sludge process, secondary clarification, tertiary filtration, UV disinfection, nitrification and denitrification, either aerobic or anaerobic sludge digestion, sludge dewatering, a sludge disposal strategy, and flow equalization. Treatment units will be enclosed with chemical scrubbing of ventilation air for odor control. The aesthetic appearance of the proposed treatment facility will be a primary objective in plant design. Details of the SBR treatment process are included in Appendix D where a preliminary design of the proposed Palo Verde Road WWTP is presented in concept.

3.2.5.1 Effluent Disposal and Quality Requirements

Effluent from the Palo Verde Road WWTP will be disposed of in four manners: 1) direct reuse for irrigation of green areas, 2) recharge of groundwater through means of recharge basins or wells, 3) reuse for irrigation in the Buckeye Water Conservation and Drainage District Canal (BID), and 4) discharge to Hassayampa River. Effluent disposal will focus on both the direct reuse of reclaimed water in order to reduce the amount of potable water consumed and indirect reuse by the use of recharge basins to offset pumping demands from local wells. Such a strategy helps to conserve water resources available to the Town of Buckeye.

Direct reuse of reclaimed water will be used to irrigate public green areas as well as private entities. This would require a distribution system including pumping, transmission and storage. All reclaimed water to be directly reused will comply with the Reclaimed Wastewater Reuse Permit, AAC Title 18 Chapter 9 Article 7 and will qualify as Class A+ Reclaimed Water as provided by AAC Title 18 Chapter 9 Article 3. Direct reuse will provide numerous recreational opportunities and aesthetic enhancements without the need for groundwater pumping to irrigate these improvements. The cost to initiate and maintain a reclaimed water distribution program can be offset by the implementation of hook-up fees and usage rates to private entities.

Another effluent management strategy is to recharge groundwater. An alternative to direct reuse is needed because the demand for reclaimed water fluctuates throughout the year and another method of effluent use is needed to accommodate those times of the year when the demand for effluent is less than the production. The effect of a recharge basin is to retard the rate of drawdown in the aquifers being pumped. Change in drawdown can be minimized as wells increasingly pump more recharged water rather than native groundwater. Also, if the net change in water usage is less than that allocated to the Town of Buckeye for the relevant aquifer(s), recharge credits may be sold to other entities that have exceeded their water allocations. All reclaimed water to be recharged will comply with the Reclaimed Wastewater Recharge Permit, AAC Title 18 Chapter 9 Article 7 and will qualify as Class A+ Reclaimed Water as provided in AAC Title 18 Chapter 9 Chapter 3.

Effluent from the proposed WWTP may also be discharged to the Buckeye Water Conservation and Drainage District Canal (BID). This reclaimed water will also be utilized for irrigation purposes as water is withdrawn from the canal downstream of the point of discharge. The effluent utilized in this manner will comply with AAC Title 18 Chapter 9 Open Access Guidelines, A+ quality reclaimed water guidelines, NPDES Permit, and the Reclaimed Wastewater Reuse Permit. Effluent reuse and recharge will be the primary disposal method. Discharge will only occur if suitable recharge and reuse areas cannot be found.

Another option for the management of reclaimed water from the proposed WWTP is to discharge to the Hassayampa River. Since this alternative offers the least benefit to the Town of Buckeye, this method should be used as a secondary alternative assuming other options are not feasible.

Several options for effluent disposal have been described with the intention to emphasize the benefits of direct reuse and recharge. However, the feasibility of

groundwater recharge as an option for effluent disposal is a function of soil characteristics and underlying geology of the area. Issues such as waterlogging and possible adverse impacts control the viability of using recharge basins to dispose of the effluent. Since geotechnical testing of potential recharge sites has not yet been performed, alternative disposal methods have been included in this report. In the event that groundwater recharge is not viable, potential outlets for reclaimed effluent include the BID and the Hassayampa River. Such alternatives would be necessary when reclaimed effluent supply exceeds demand.

3.2.5.2 Storm water Discharge

Storm water discharges associated with the WWTP are not anticipated. The facility will retain onsite all storm water runoff generated by storms up to and including the 100-year, 2-hour storm. Therefore there will be no storm water discharges from the Palo Verde Road WWTP up to and including the 100-year, 2-hour event.

3.3 Sanitary Districts, Private Utilities, and WWTP Service Areas

The location of the Palo Verde Road WWTP and its service area are shown on the Palo Verde Road WWTP Amendment Map included in Appendix A. There are no existing wastewater treatment facilities, sanitary districts, or certified service areas that would be impacted by the WWTP or discharge.

3.4 Summary of Alternatives

In order to accommodate anticipated growth within the proposed service area, the Town of Buckeye must find some method for treatment of wastewater and the subsequent disposal of the reclaimed wastewater. Due to the location and capacity of the existing Buckeye Treatment Facility, the only viable option is construction of a new facility.

The Town would like to have as many possibilities for effluent disposal as possible. Each of the following alternatives may be used alone or in combination with other alternatives.

The proposed alternatives are as follows:

- Reuse of reclaimed wastewater at green areas.
- Groundwater recharge to basins or wells.
- Reuse of reclaimed wastewater to the Buckeye Water Conservation and Drainage District Canal.
- Discharge of reclaimed wastewater to the Hassayampa River.

The Town will evaluate each disposal method based on the following criteria: 1) the disposal method should not have a negative impact on the environment, 2) the disposal method will be implemented prior to the anticipated start-up date which is anticipated to be between March and September of 2005, and 3) the disposal approach must be flexible and efficient from a financial, construction, and maintenance viewpoint.

3.5 Permitting Requirements

The required permits from ADEQ and ADWR will be obtained in the Town of Buckeye's name. The Palo Verde Road WWTP will require the following permits or approvals:

Table 3.2: Listing of Regulatory Reviews, Plans, Approvals, Permits and Certifications

Requirement	Regulatory Agency
Approval to Construct	Maricopa County Environmental Services Department
Approval of Construction	Maricopa County Environmental Services Department
Aquifer Protection Permit	Arizona Department of Environmental Quality
Reclaimed Wastewater Recharge Permit	Arizona Department of Water Resources
Reclaimed Wastewater Reuse Permit	Arizona Department of Environmental Quality
Arizona Pollutant Discharge Elimination System (AzPDES) Permit	Arizona Department of Environmental Quality
Sludge Disposal Agreement	Arizona Department of Environmental Quality
Air Quality Permit	Maricopa County Environmental Services Department
208 Amendment	Town of Buckeye, MAG Water Quality Advisory Committee, MAG Management Committee, MAG Regional Council, State WQMWG, ADEQ, EPA
Grading Permit	Town of Buckeye
Architectural Approval	Town of Buckeye, Westwind Properties, Newport Development
Building Permit	Town of Buckeye
Annual Operating Permit	Maricopa County Environmental Services Department
Storm Water National Pollutant Discharge Elimination System (NPDES) Permit	Arizona Department of Environmental Quality

3.6 Pretreatment Requirements

Future commercial development within the airport as well as in the surrounding vicinity will likely be occupied by some industrial users that may require pretreatment before discharging into the future sanitary sewer system. The Town of Buckeye will assess future industrial users and their respective manufacturing processes on an individual basis. Each prospective industrial user will be required to be in compliance with all pretreatment requirements dictated by the Town of Buckeye and all federal pretreatment requirements as provided in 40 CFR Part 403 and enforced by Arizona Department of Environmental Quality. The ability for prospective industrial users to comply with both federal and local regulations will be evaluated on a case-by-case basis.

3.7 Sludge Management

The sludge from the Palo Verde Road WWTP will be of such a quality that it may be used for agricultural purposes. There is not an end user for this product at this time; however, the options for sludge disposal will remain open. The sludge may also be delivered to a landfill for disposal. A valid sludge hauler and sludge disposal permit will be obtained.

4 Construction, Operation, and Maintenance

4.1 Construction Responsibility

Westwind Properties and Newport Development will bid the design and construction of the Palo Verde Road WWTP. Construction will be accomplished under the resultant contract from this bidding process. The winning bidder will be responsible for the construction of the facility. The timing of construction of each phase will be dependent upon the increases in population and the resultant wastewater flows. The project will be divided into phases. Phase 1A of construction is anticipated to be complete between March and September of 2005. There is not a schedule for further phasing at this point in time. In general, design of each additional phase must begin when 70% of the plant capacity has been reached as determined from platted properties to be served by the plant or measured flow from the collection system. Construction of each phase must begin when 80% of the plant capacity has been reached as determined from recorded properties to be served by the plant or measured flow from the collection system.

4.2 Operation and Maintenance Responsibility

Once the construction of this facility is complete the Town of Buckeye will own the facility. The Town of Buckeye will oversee the operation and maintenance of the facility. The Town may publicly bid the operation and maintenance services or directly hire qualified and licensed operators. Operation and maintenance shortfalls will be met by the Developers.

4.3 Sources of Construction Pollution

Construction of the Palo Verde Road WWTP will not be a pollution intensive activity. Anticipated pollutants may include dust from construction activities, construction-related solid waste, and inert material. The construction will be conducted under an Air Quality Permit from MCESD, and will comply with the provisions of the permit. Any wastes generated during construction will be properly managed and disposed of at an appropriate facility.

5 Financing

5.1 Financing Plan

Westwind Properties and Newport Development will be responsible for the financing of this project. Financing for the expansion of the Palo Verde Road WWTP will also be provided by Westwind Properties and Newport Development for up to 3.3 MGD capacity. Further expansion of the WWTP will be financed by the Town of Buckeye in association with other developers. A preliminary estimate of construction costs for each treatment plant phase are shown below in Table 3.3.

Table 3.3 Preliminary Estimate of Construction Costs for Palo Verde Road WWTP

Construction Phase	1A	1B	2	3	4	5
Individual Capacity	0.5 MGD	0.5 MGD	1 MGD	2 MGD	4 MGD	2.2 MGD
Cumulative Capacity	0.5 MGD	1.0 MGD	2 MGD	4 MGD	8 MGD	10.2 MGD
	\$4,687,500	\$ 5,796,900	\$7,585,950	\$ 9,500,000	\$ 8,906,300	\$5,468,800

5.2 Financing Capacity to Construct

Westwind Properties and Newport Development will provide the initial capital needed for design and construction of the Palo Verde Road WWTP. Upon completion, ownership of the plant will be transferred to the Town of Buckeye.

5.3 Financing Capacity to Operate

The operation and maintenance of the Palo Verde WWTP will be funded and overseen by the Town of Buckeye whether the Town publicly bids the operation and maintenance services or directly hires qualified and licensed operators. User fees will be collected by the Town of Buckeye to fund operation and maintenance over the life of the Palo Verde Road WWTP. While a population base is in the early stages of growth within the plant's service area, operation and maintenance costs will need to be subsidized until connection fees can cover operation and maintenance expenses. Developments connecting to the system will provide such subsidies until connection fees are sufficient to fund operation and maintenance costs.

6 Impacts and Implementation

6.1 Implementation Plan

This application will identify a separate service area for the Palo Verde Road WWTP. The initial phase is scheduled for completion between March and September of 2005. Phase 1A is anticipated to have a treatment capacity of 0.5 MGD. Further phasing is anticipated to proceed such that Phase 1 at completion will provide 1.0 MGD of treatment capacity, Phase 2 will provide 2.0 MGD, Phase 3 will provide 4.0 MGD, Phase 4 will provide 8.0 MGD, and ultimate plant capacity at full build-out will provide 10.2 MGD of treatment capacity, based on average day generation. The timing of plant expansion will depend on the demand placed by commercial and residential development in the Out Parcel areas. Since commercial development is still in the planning phases, a schedule for phasing is uncertain at this point in time. In general, design of each additional phase must begin when 70% of the plant capacity has been reached as determined from platted properties to be served by the plant or measured flow from the collection system. Construction of each phase must begin when 80% of the plant capacity has been reached as determined from recorded properties to be served by the plant or measured flow from the collection system. Ultimate capacity of the Palo Verde Road WWTP will be 10.2 MGD.

6.2 Impacts of the Proposed Plan

The implementation of the Palo Verde Road WWTP is not anticipated to have any impact on adjacent municipalities, existing service areas, sanitary districts, communities, or businesses. The discharge, reuse, or recharge is not anticipated to increase a noticeable insect population or odor.

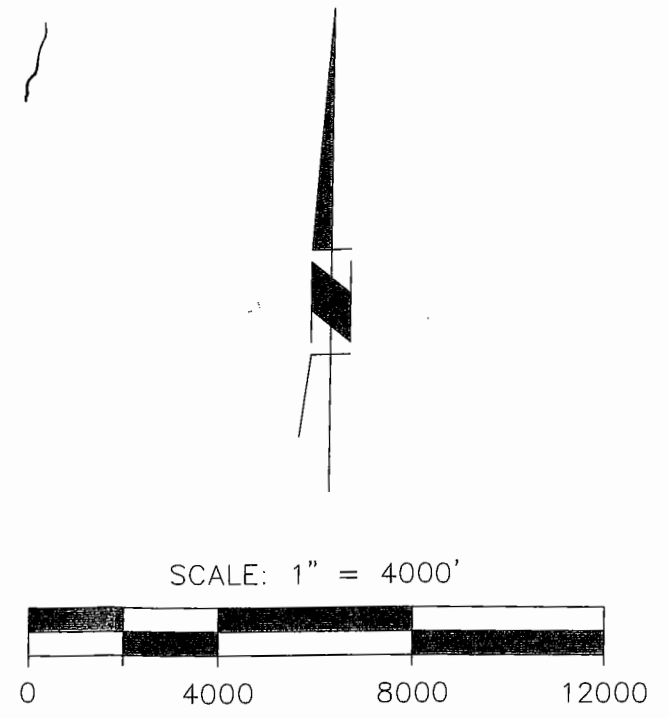
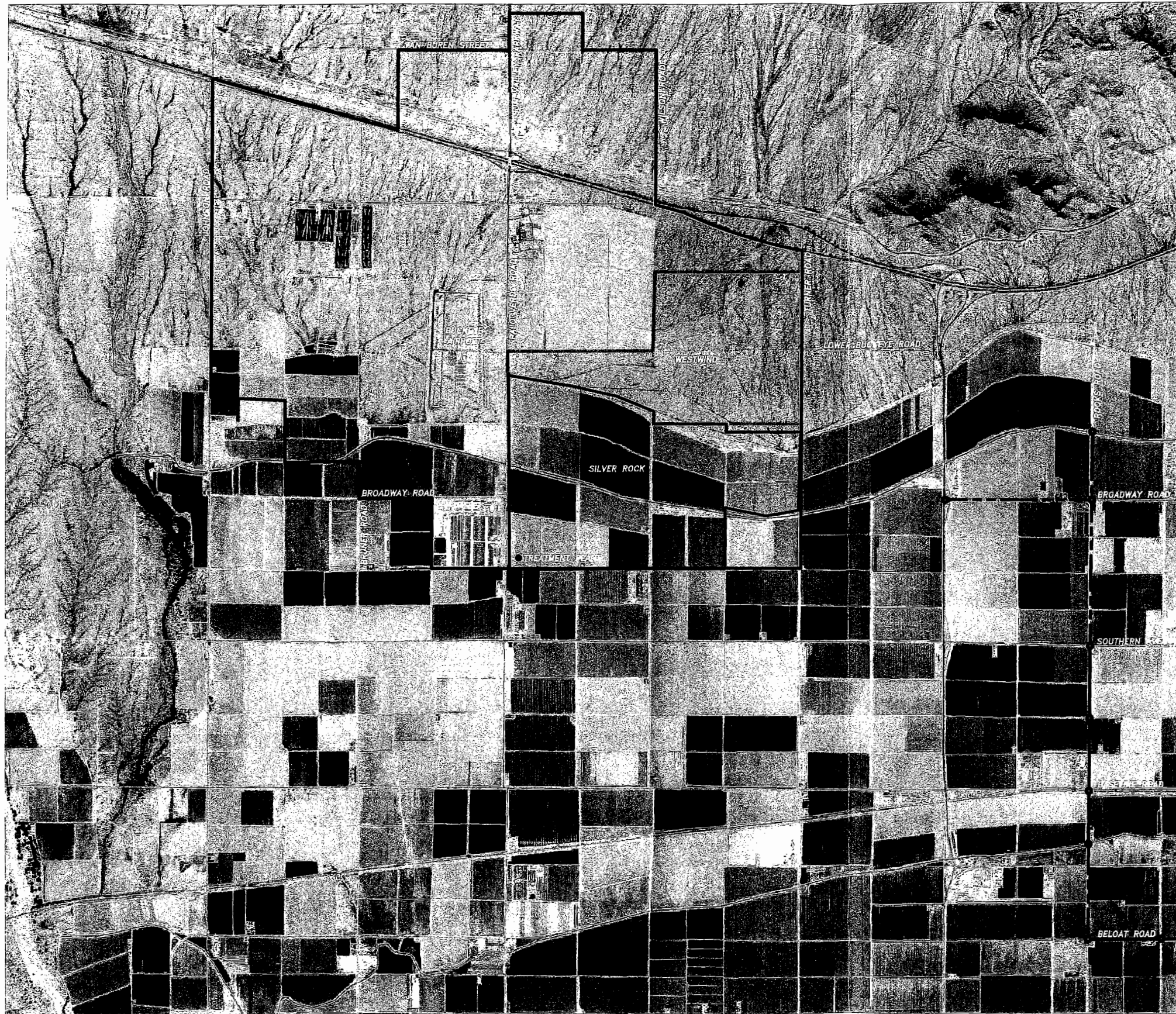
7 Public Participation

MAG is responsible, with the cooperation with the Town of Buckeye, for ensuring that the required public participation requirements are followed as outlined in 40 CFR 25. The following are minimum requirements:

- Submittal of a mailing list used to notify the public of the public hearing.
- Listing of locations where documents are available for review at least 30 days prior to the public hearing.
- Publication of public notice of the public hearing with information on time, date, subject, and location of public hearing at least 45 days prior to the public hearing.
- Submittal of an affidavit of publication for official newspaper publication.
- Submittal of a responsiveness summary for public hearing.

Appendix A

Maps



LEGEND:

- WESTWIND PROJECT BOUNDARY
- SILVER ROCK PROJECT BOUNDARY
- PALO VERDE ROAD WWTP SERVICE AREA
- - - PROPOSED SEWER LINE
- WWTP

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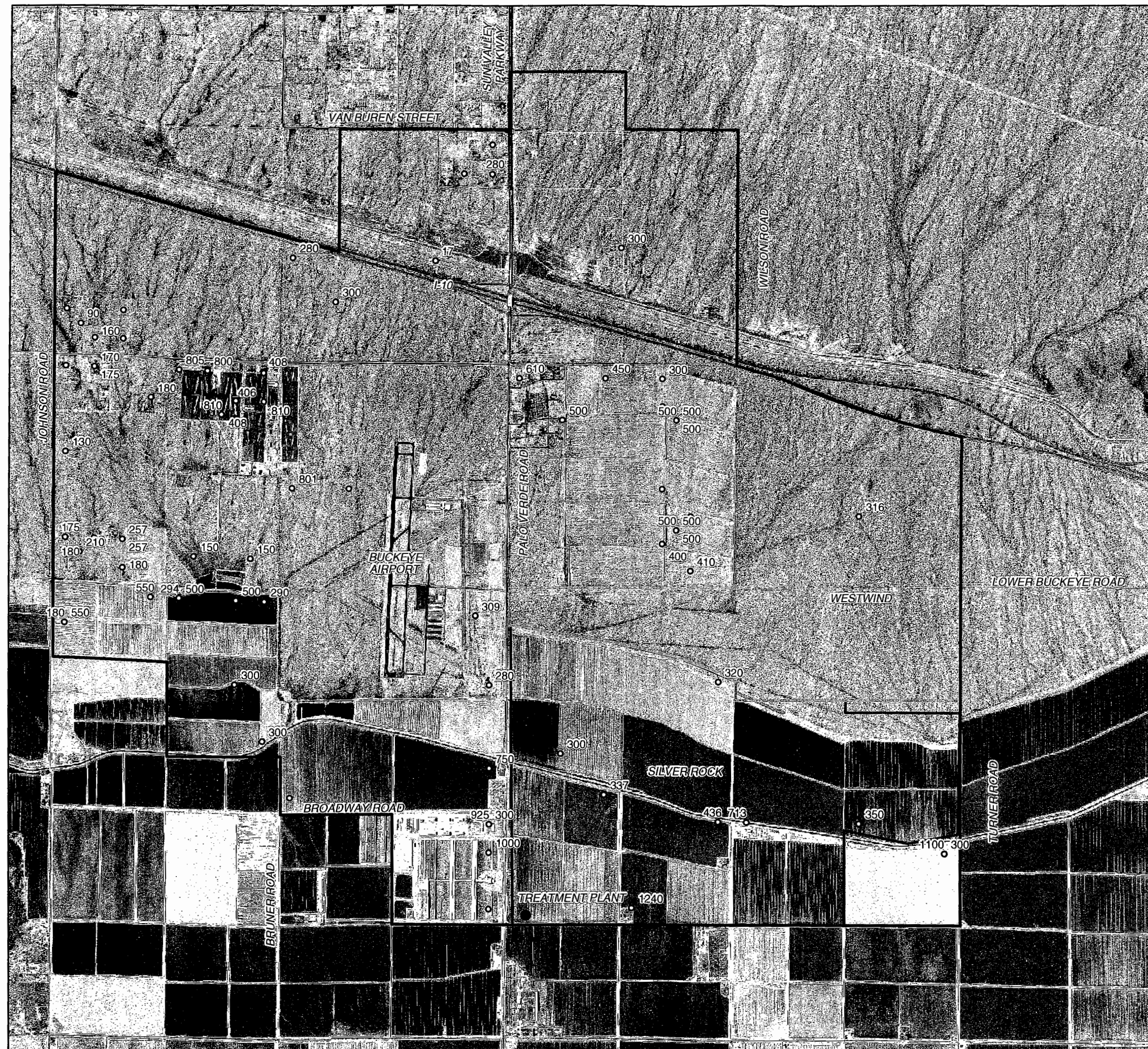
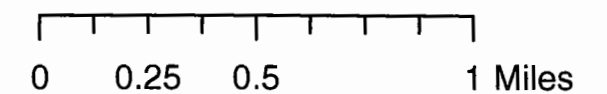
PALO VERDE ROAD WWTP SERVICE AREA

EXISTING WELL LOCATIONS

Legend

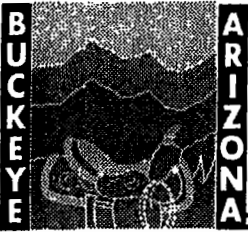
- EXISTING WELLS
- ▭ SERVICE AREA BOUNDARY
- ▭ WESTWIND BOUNDARY
- ▭ SILVER ROCK BOUNDARY

NUMBER VALUES REPRESENT WELL DEPTHS IN FEET



Appendix B

Financial Information



Town of Buckeye

June 10, 2004

Ms. Lindy Bauer, Environmental Program Coordinator
Maricopa Association of Governments
302 N. 1st Avenue, Suite 300
Phoenix, AZ 85003

Re: Palo Verde Road Wastewater Treatment Plant

Dear Ms. Bauer:

The Town of Buckeye is responsible for the operation, maintenance, and closure of the Palo Verde Road Wastewater Treatment Plant located in the Town of Buckeye, Arizona. The estimated cost of the new facility's operation and maintenance is \$450,000 per year. The Town of Buckeye will collect operation and maintenance costs from individual users through monthly service fees.

The total estimated closure costs for the Palo Verde Road Wastewater Treatment Plant is \$900,000. The Town of Buckeye is financially capable of meeting this cost. Closure costs will be collected over the life of the facility through monthly service fees from the individual users. There are no post-closure costs expected for this facility.

Sincerely,

Town of Buckeye

Mary Jo Saiz
Finance Director

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2002

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 1-9977

MERITAGE  CORPORATION®

(Exact Name of Registrant as specified in its charter)

Maryland
(State or other jurisdiction of incorporation or organization)

86-0611231
(IRS Employer Identification No.)

8501 E. Princess Drive, Suite 290
Scottsdale, Arizona
(Address of principal executive offices)

85255
(Zip Code)

(480) 609-3330
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, \$.01 par value New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ____

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ____

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes X No ____

The aggregate market value of common stock held by non-affiliates of the registrant (10,215,050 shares) as of June 28, 2002, was \$466,317,033, based on the closing sales price per share as reported by the New York Stock Exchange on such date. The aggregate market value of common stock held by non-affiliates of the registrant (9,590,758 shares) as of March 14, 2003, was \$309,877,391, based on the closing sales price per share as reported by the New York Stock Exchange on such date. For purposes of these computations, all executive officers and directors of the registrant have been deemed to be affiliates.

The number of shares outstanding of the registrant's common stock on March 14, 2003 was 12,938,634.

DOCUMENTS INCORPORATED BY REFERENCE

Portions from the registrant's Proxy Statement relating to the Annual Meeting of Stockholders to be held on May 21, 2003 have been incorporated by reference into Part III, Items 10, 11, 12 and 13.

**MERITAGE CORPORATION
FORM 10-K
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PART I

Item 1. Business

We are a leading designer and builder of single-family homes in the rapidly growing Sunbelt states of Texas, Arizona, California and Nevada. We focus on providing a broad range of first-time, move-up and luxury homes to our targeted customer base. We and our predecessors have operated in Arizona since 1985, in Texas since 1987 and in Northern California since 1989. We expanded our presence in Texas with the July 2002 acquisition of Hammonds Homes (Hammonds), a builder that focuses on the move-up market in the Houston, Dallas/Ft. Worth and Austin areas. We entered the Las Vegas, Nevada market in October 2002 with our acquisition of Perma-Bilt Homes (Perma-Bilt), another move-up builder.

We operate in Texas as Legacy Homes, Monterey Homes and Hammonds Homes, in Arizona as Monterey Homes, Meritage Homes and Hancock Communities, in Northern California as Meritage Homes and in Nevada as Perma-Bilt Homes. At December 31, 2002, we were actively selling homes in 128 communities, with base prices ranging from \$92,000 to \$910,000. We have four primary segments: Texas, Arizona, California and Nevada. See Note 10 to our consolidated financial statements included in this report for information regarding our segments.

Available Information

Information about our company and communities is provided through our Internet web site at www.meritagehomes.com. Our periodic and current reports and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") are available, free of charge, on our website as soon as reasonably practicable after electronically filing such reports with the Securities and Exchange Commission ("SEC"). The information on our website is not considered part of this report.

Competitive Strengths

We believe we possess the following competitive strengths:

Conservative inventory management. We seek to minimize land and inventory risk in order to optimize our use of capital and maintain moderate leverage ratios. We accomplish this by:

- generally purchasing land subject to complete entitlements, including zoning and utility services;
- developing smaller parcels, generally projects that can be completed within a three-year period;
- controlling approximately 81% of our land inventory through rolling options with initial deposit requirements typically between 2% and 15% of the land price;
- managing housing inventory by pre-selling and obtaining substantial customer deposits on our homes prior to starting construction;
- limiting unsold home construction; and
- minimizing home construction cycles.

Disciplined financial management. We believe that our disciplined financial management policies enable us to achieve above-average returns on assets compared to our competitors in the homebuilding industry and maintain reasonable leverage ratios. Our rigorous investment requirements for the acquisition of land enable us to deploy capital efficiently and to generate strong cash flows to fund the acquisition of additional land or homebuilding operations.

Strong margins. Our focus on achieving high margins results in greater profitability during strong economic periods and also enables us to realize lower break-even points and higher pricing flexibility during slower economic periods. In addition to maintaining low overhead costs, we actively manage construction costs and pricing and marketing strategies in order to maximize margins. We seek to optimize our mix of available housing upgrades and customization features to offer the highest value to customers at the lowest cost. Within our pricing structure we provide our sales and marketing professionals with the autonomy and flexibility to respond rapidly to changing market dynamics by customizing our sales programs.

Experienced management team with significant equity ownership. Members of our senior management team have extensive experience in the homebuilding industry as well as in each of the local markets that we serve. Our co-chief executive officers and senior executives average over 17 years of homebuilding experience and each has a successful track record of delivering superior results in varying homebuilding cycles. In addition, our co-chief executive officers together beneficially own approximately 22% of our outstanding common stock.

Product breadth. We believe that our product breadth and geographic diversity enhance our growth potential and help to reduce exposure to economic cycles. In Arizona, we serve the first-time and move-up markets, and in 2002, we began delivering homes in the age-restricted active adult community market. We also build within the Arizona, and beginning in 2002, the Texas and California luxury markets, characterized by unique communities and distinctive luxury homes. In Texas we mainly target the first and second-time move-up markets, and in Northern California and Nevada, we focus primarily on move-up homes.

Business Strategy

We seek to distinguish ourselves from other production homebuilders through business strategies focused on the following:

Focus on high growth markets. Our housing markets are located in four rapidly growing Sunbelt states; Texas, Arizona, California and Nevada. These areas are generally characterized by high job growth and in-migration trends, creating strong demand for new housing. We believe they represent attractive homebuilding markets with opportunities for long-term growth. We believe our operations in these markets are well established and that we have developed a reputation for building distinctive quality homes within our markets.

Expand into new and within existing markets. We continuously evaluate expansion opportunities through strategic acquisitions of other homebuilders and internal growth through expansion of our product offering in existing markets or start-up operations in new geographic markets. In pursuing expansion, we explore markets with demographic and other growth characteristics similar to our current markets and seek the acquisition of entities with operating policies, cash flow and earnings-focused philosophies similar to ours.

In the past six years we have successfully completed five acquisitions. They have enabled us to substantially increase our revenues and earnings, expand into new markets, increase our market share in existing markets and add new product lines, such as age-restricted housing for the Arizona retirement market.

Maintain low cost structure. Throughout our history, we have focused on minimizing construction costs and overhead, and we believe this attention is a key factor in maintaining high margins and profitability. We reduce costs by:

- using subcontractors for home construction and site improvement on a fixed-price basis;
- obtaining favorable pricing from subcontractors through long-term relationships and high volume;
- reducing interest carry by minimizing our inventory of unsold or speculative homes and shortening the home construction cycle;
- generally beginning construction on a home once it is under contract, we have received a satisfactory earnest money deposit and the buyer has obtained preliminary approval for a mortgage loan;
- minimizing overhead by centralizing certain administrative activities; and
- monitoring homebuilding production, scheduling and budgeting through management information systems.

Superior design, quality and customer service. We believe we maximize customer satisfaction by offering homes that are built with quality materials and craftsmanship, exhibit distinctive design features and are situated in premium locations. We believe that we generally offer higher caliber homes in their defined price range or category compared to those built by our competitors. In addition, we are committed to achieving the highest level of customer satisfaction as an integral part of our competitive strategy. As part of the sales process, our experienced sales personnel keep customers informed of their home's construction progress. After delivery, our customer care departments respond to homebuyers' questions and warranty matters.

Products

Our homes range from first-time purchases to semi-custom luxury, with base prices ranging from \$92,000 to \$910,000. A summary of activity by state and product type as of and for the year ended December 31, 2002, follows (dollars in thousands):

	Number of Homes Closed	Average Closing Price	Homes in Backlog	Dollar Value of Backlog	Home Sites Remaining ⁽¹⁾	Number of Active Communities
Texas - First-time	-	-	5	\$ 844	264	1
Texas - Move-up	2,073	\$ 183	1,055	207,421	8,462	80
Texas - Luxury	17	428	25	10,634	97	3
Arizona - Age Restricted	107	203	76	15,776	7,508	4
Arizona - First-time	445	110	7	838	338	1
Arizona - Move-up	1,061	279	326	88,194	3,573	18
Arizona - Luxury	122	641	57	39,347	282	6
California - Move-up	540	397	279	108,620	1,745	7
California - Luxury	54	574	54	28,307	654	3
Nevada - Move-up	155	221	186	37,783	2,143	5
Total	<u>4,574</u>	<u>\$ 243</u>	<u>2,070</u>	<u>\$ 537,764</u>	<u>25,066</u>	<u>128</u>

(1) "Home Sites Remaining" is the estimated number of homes that could be built both on the remaining lots available for sale and land to be developed into lots.

Land Acquisition and Development

We typically option or purchase land only after necessary entitlements have been obtained so that development or construction may begin as market conditions dictate. The term "entitlements" refers to development agreements, tentative maps or recorded plats, depending on the jurisdiction within which the land is located. Entitlements generally give the developer the right to obtain building permits upon compliance with conditions that are ordinarily within the developer's control. Even though entitlements are usually obtained before land is purchased, we are still required to secure a variety of other governmental approvals and permits during development. The process of obtaining such approvals and permits can substantially delay the development process. For this reason, we may consider, on a limited basis, purchasing unentitled property in the future when we can do so in a manner consistent with our business strategy. Although historically we have generally developed parcels ranging from 100 to 300 lots, in order to achieve and maintain an adequate inventory of lots, we are beginning to purchase larger parcels, in some cases with a joint venture partner.

We select land for development based upon a variety of factors, including:

- internal and external demographic and marketing studies;
- project suitability, which generally means developments with fewer than 300 lots;
- suitability for development generally within a one to four-year time period from the beginning of the development process to the delivery of the last home;
- financial review as to the feasibility of the proposed project, including projected profit margins, returns on capital employed, and the capital payback period;
- the ability to secure governmental approvals and entitlements;
- results of environmental and legal due diligence;
- proximity to local traffic corridors and amenities; and
- management's judgment as to the real estate market and economic trends, and our experience in particular markets.

We acquire land through purchases and rolling option contracts. Purchases are financed through our revolving credit facility or working capital. Acquiring our land through rolling option contracts allows us to control lots and land through third parties who own or buy properties on which we plan to build homes. We enter into option contracts to purchase finished lots from these third parties as home construction begins. These contracts are generally non-recourse and

generally require non-refundable deposits of 2% to 15% of the sales price. At December 31, 2002, we had approximately \$77.5 million in deposits and \$15.1 million in letters of credit on real estate under option or contract.

Once we acquire land, we generally initiate development through contractual agreements with subcontractors. These activities include site planning and engineering, as well as constructing road, sewer, water, utilities, drainage, recreation facilities and other refinements. We often build homes in master-planned communities with home sites that are along or near a major amenity, such as a golf course.

We develop a design and marketing concept for each project, which includes determination of size, style and price range of homes. For these projects, we also determine street layout, individual lot size and layout, and overall community design. The product line offered in each project depends upon many factors, including the housing generally available in the area, the needs of a particular market, and our lot costs for the project; though we are sometimes able to use standardized design plans for a product line.

To a limited extent, we may use joint ventures to purchase and develop land where such arrangements are necessary to acquire the property or appear to be otherwise economically advantageous. At December 31, 2002, we were involved in five such joint ventures which are accounted for using the equity method. Our investment in these entities of approximately \$9.3 million is classified within other assets on our December 31, 2002 consolidated balance sheet.

The following table presents information regarding land owned or land under contract or option by market as of December 31, 2002:

	Land Owned ⁽¹⁾			Land Under Contract or Option ⁽¹⁾			Total
	Finished Lots	Lots Under Development (estimated)	Lots Held for Development (estimated)	Finished Lots	Lots Under Development (estimated)	Lots Held for Development (estimated)	
TEXAS:							
Dallas/Ft. Worth	955	228	874	591	895	--	3,543
Houston	616	258	--	596	955	810	3,235
Austin	313	56	45	611	989	--	2,014
San Antonio	--	--	--	--	--	370	370
Total Texas	1,884	542	919	1,798	2,839	1,180	9,162
ARIZONA:							
Phoenix/Scottsdale	701	--	--	--	6,003	1,343	8,047
Tucson	137	--	--	415	2,293	744	3,589
Total Arizona	838	--	--	415	8,296	2,087	11,636
CALIFORNIA:							
Sacramento	47	--	--	185	444	--	676
East San Francisco Bay	62	340	20	203	1,152	--	1,777
Total California	109	340	20	388	1,596	--	2,453
NEVADA:							
Las Vegas	--	181	--	--	505	1,457	2,143
TOTAL	2,831	1,063	939	2,601	13,236	4,724	25,394

(1) Excludes lots with finished homes or homes under construction.

Construction Operations

We are the general contractor for our projects and typically hire subcontractors on a project-by-project or reasonable geographic-proximity basis to complete construction at a fixed price. We usually enter into agreements with subcontractors and materials suppliers after receiving competitive bids on an individual basis. We obtain information from prospective subcontractors and suppliers with respect to their financial condition and ability to perform their

agreements before formal bidding begins. Occasionally, we enter into longer-term contracts with subcontractors and suppliers if we can obtain more favorable terms. Our project managers and field superintendents coordinate and supervise the activities of subcontractors and suppliers, subject the development and construction work to quality and cost controls, and assure compliance with zoning and building codes. At December 31, 2002, we employed 406 construction operations personnel.

We specify that quality, durable materials be used in construction of our homes and we do not maintain significant inventories of construction materials, except for work in process materials for homes under construction. When possible, we negotiate price and volume discounts with manufacturers and suppliers on behalf of our subcontractors to take advantage of production volume. Historically, access to our principal subcontracting trades, materials and supplies has been readily available in each of our markets. Prices for these goods and services may fluctuate due to various factors, including supply and demand shortages that may be beyond the control of our vendors. We believe that we have strong relationships with our suppliers and subcontractors.

We generally build and sell homes in clusters or phases within our larger projects, which we believe creates efficiencies in land development and construction, and improves customer satisfaction by reducing the number of vacant lots surrounding a completed home. Our homes are typically completed within four to nine months from the start of construction, depending upon home size and complexity. Construction schedules may vary depending on the availability of labor, materials and supplies, product type, location and weather. Our homes are usually designed to promote efficient use of space and materials, and to minimize construction costs and time. We do not enter into any weather or materials commodity futures derivative contracts.

Marketing and Sales

We believe that we have an established reputation for developing high quality homes, which helps generate interest in each new project. We also use advertising and other promotional activities, including our website at www.meritagehomes.com, magazine and newspaper advertisements, brochures, direct mailings, and the placement of strategically located signs in the immediate areas of our developments.

We use furnished model homes as tools in demonstrating the competitive advantages of our home designs and various features to prospective homebuyers. We generally employ or contract with interior and landscape designers who are responsible for creating an attractive model home for each product line within a project. We generally build between one and four model homes for each active community, depending upon the number of homes to be built in the project and the products to be offered. Often, we lease our model homes from institutional investors who own the homes for investment purposes or from buyers who do not intend to occupy the home immediately. A summary of model homes owned or leased at December 31, 2002, follows:

	<u>Model Homes Owned</u>	<u>Model Homes Leased</u>	<u>Monthly Lease Amount</u>	<u>Models Under Construction</u>
Texas	53	58	\$ 53,002	16
Arizona	14	64	130,028	20
California	—	38	52,720	14
Nevada	<u>1</u>	<u>19</u>	<u>22,533</u>	<u>—</u>
Total	<u>68</u>	<u>179</u>	<u>\$ 258,283</u>	<u>50</u>

Our homes generally are sold by full-time, commissioned employees who typically work from a sales office located in one of the model homes for each project. At December 31, 2002, we had 248 sales and marketing employees. Our goal is to ensure that our sales force has extensive knowledge of our operating policies and housing products. To achieve this goal, we train our sales personnel and conduct periodic meetings to update them on sales techniques, competitive products in the area, financing availability, construction schedules, marketing and advertising plans, and the available product lines, pricing, options and warranties offered. Sales personnel are licensed real estate agents where required by law. Independent brokers also sell our homes, and are usually paid a sales commission based on the price of the home. Our sales personnel assist our customers in selecting upgrades or in adding available customization features to their homes. We attempt to present our available upgrade and customization options to appeal to local consumer demands while at the same time minimizing our costs. Occasionally we offer various sales incentives, such as

landscaping and certain interior home improvements, to attract buyers. The use and type of incentives depends largely on economic and competitive market conditions.

Backlog

Most of our home sales are made under standard sales contracts signed before construction of the home begins. The contracts require substantial cash deposits and are usually subject to certain contingencies such as the buyer's ability to qualify for financing. Homes covered by such sales contracts but not yet closed are considered "backlog." Sales contingent upon the sale of a customer's existing home are not included as new sales contracts until the contingency is removed. We do not recognize revenue upon the sale of a home until it is delivered to the homebuyer and other criteria for sale and profit recognition are met. We sometimes build homes before obtaining a sales contract, however, these homes are excluded from backlog until a sales contract is signed. At December 31, 2002, 11% of our inventory was comprised of homes under construction without sales contracts, and 5% of inventory were completed homes without sales contracts. We believe that we will deliver substantially all homes in backlog at December 31, 2002 to customers during 2003.

Our backlog increased to 2,070 units with a value of \$537.8 million at December 31, 2002 from 1,602 units with a value of \$375.0 million at December 31, 2001. These increases are primarily due to our acquisition of two homebuilders during the year, additional communities that opened for sale in 2002, along with continued buyer demand for homes.

Customer Financing

We attempt to help qualified homebuyers who require financing to obtain loans from mortgage lenders that offer a variety of financing options. We provide mortgage-broker services in some of our markets through investments in mortgage-brokers which originate loans on behalf of third party lenders. In other markets we use unaffiliated preferred mortgage lenders. We may pay a portion of the closing costs and discount mortgage points to assist homebuyers with financing. We do not fund or service the mortgages obtained by our home buyers, and therefore do not assume the risks associated with a mortgage banking business. Since many customers use long-term mortgage financing to purchase homes, adverse economic conditions, increases in unemployment and rising mortgage interest rates may deter or reduce the number of potential homebuyers.

Customer Relations, Quality Control and Warranty Programs

We believe that positive customer relations and an adherence to stringent quality control standards are fundamental to our continued success, and that our commitment to buyer satisfaction and quality control has significantly contributed to our reputation as a high quality builder.

A Meritage project manager or project superintendent and a customer relations representative generally oversee compliance with quality control standards for each community. These representatives perform the following tasks:

- oversee home construction;
- oversee subcontractor and supplier performance;
- review the progress of each home and conduct formal inspections as specific stages of construction are completed; and
- regularly update buyers on the progress of their homes.

We generally provide a one-year limited warranty on workmanship and building materials with each home. As subcontractors usually provide an indemnity and a certificate of insurance before beginning work, claims relating to workmanship and materials are generally the subcontractors' responsibility. Reserves for future warranty costs are established based on historical experience within each division or region, and are recorded when the homes are delivered. Reserves generally range from 0.45% to 0.75% of a home's sale price. Historically, these reserves have been sufficient to cover warranty repairs.

Competition and Market Factors

The development and sale of residential property is a highly competitive industry. We compete for sales in each of our markets with national, regional, and local developers and homebuilders, existing home resales, and to a lesser extent, condominiums and rental housing. Some of our competitors have significantly greater financial resources, lower costs and/or more favorable land positions than we do. Competition among both small and large residential homebuilders is based on a number of interrelated factors, including location, reputation, amenities, design, quality and price. We believe that we compare favorably to other homebuilders in the markets in which we operate due to our:

- experience within our geographic markets which allows us to develop and offer new products;
- ability to recognize and adapt to changing market conditions, including from a capital and human resource perspective;
- ability to capitalize on opportunities to acquire land on favorable terms; and
- reputation for outstanding service and quality products.

Government Regulation and Environmental Matters

We option or purchase most of our land after entitlements have been obtained, which provide for zoning and utility services to project sites and give us the right to obtain building permits. Construction may begin almost immediately on such entitled land upon compliance with and receipt of specified permits, approvals and other conditions, which generally are within our control. The time needed to obtain such approvals and permits affects the carrying costs of unimproved property acquired for development and construction. The continued effectiveness of permits already granted is subject to factors such as changes in government policies, rules and regulations, and their interpretation and application. To date, the government approval processes discussed above have not had a material adverse effect on our development activities, although there is no assurance that these and other restrictions will not adversely affect future operations.

Local and state governments have broad discretion regarding the imposition of development fees for projects under their jurisdictions. These fees are normally established when we receive recorded maps and building permits. In addition, communities occasionally impose construction moratoriums. Because most of our land is entitled, construction moratoriums generally would affect us if they arose from health, safety or welfare issues, such as insufficient water, electric or sewage facilities. We could become subject to delays or may be precluded entirely from developing communities due to building moratoriums, "no growth" or "slow growth" initiatives or building permit allocation ordinances, which could be implemented in the future.

We are also subject to a variety of local, state, and federal statutes, ordinances, rules and regulations concerning the protection of health and the environment. In some markets, we are subject to environmentally sensitive land ordinances that mandate open space areas with public elements in housing developments, and prevent development on hillsides, wetlands and other protected areas. We must also comply with flood plain restrictions, desert wash area restrictions, native plant regulations, endangered species acts and view restrictions. These and similar laws may result in delays, cause substantial compliance and other costs, and prohibit or severely restrict development in certain environmentally sensitive regions or areas. To date, compliance with such ordinances has not materially affected our operations, although it may do so in the future.

We usually will condition our obligation to option or purchase property on, among other things, an environmental review of the land. To date, we have not incurred any unanticipated liabilities relating to the removal of unknown toxic wastes or other environmental matters. However, there is no assurance that we will not incur material liabilities in the future relating to toxic waste removal or other environmental matters affecting land currently or previously owned.

Sarbanes-Oxley Act of 2002

On July 30, 2002, the Sarbanes-Oxley Act of 2002 (SOA) was signed into law. The stated goals of the SOA are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The SOA is the most far-reaching U.S. securities legislation enacted in some time. The SOA generally applies to all companies that file or are required to file periodic reports with the SEC under the Exchange Act. Given the extensive SEC role in implementing rules relating to many of the SOA's new requirements, the final scope of some of these requirements remains to be determined.

The SOA includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules, and mandates further studies of certain issues by the SEC and the Comptroller General. The SOA represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

The SOA addresses, among other matters, audit committees; certification of financial interests by the chief executive officer and the chief financial officer; the forfeiture of bonuses and profits made by directors and senior officers in the twelve month period covered by restated financial statements; a prohibition on insider trading during pension plan black-out periods; disclosure of off-balance sheet transactions; a prohibition on personal loans to directors and officers; expedited filing requirements for stock transaction reports by officers and directors; disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code; "real time" filing of periodic reports; the formation of a public accounting oversight board; auditor independence; and various increased criminal penalties for violations of securities laws.

The SOA contains provisions that became effective upon enactment on July 30, 2002 and other provisions that will become effective within one year from enactment. The SEC has been delegated the task of enacting rules to implement various of the provisions with respect to, among other matters, disclosure in periodic filings pursuant to the Exchange Act.

Employees and Subcontractors

At December 31, 2002, we had 869 employees, including 215 in management and administration, 248 in sales and marketing, and 406 in construction operations. Our employees are not unionized, and we believe that we have good employee relationships. We act solely as a general contractor and all construction operations are conducted by our project managers and field superintendents who manage third party subcontractors. We use independent contractors for construction, architectural and advertising services, and we believe that we have good relationships with our subcontractors and independent contractors.

Item 2. Properties

Our corporate offices are leased properties located in Scottsdale, Arizona, and Plano, Texas. The Scottsdale lease expires in February 2006. The Plano lease expires in May 2005 and the building is leased from a company owned beneficially by one of our co-chairmen. We believe that the Plano lease rate is competitive with rates for comparable space in the area and the terms of the lease are similar to those we could obtain in an arm's length transaction. We lease an aggregate of approximately 92,800 square feet of office space in our markets for our operating divisions and corporate and executive offices. These leases expire between May 2003 and March 2007.

As of December 31, 2002, we also had leases for 179 model homes and lots with terms ranging from three months to 36 months, with various renewal options. Our aggregate monthly lease amount is approximately \$258,000.

The following schedule summarizes our leased real estate for each of our operating segments.

	<u>Monthly Office Lease Amount</u>	<u>Approximate Square Footage</u>	<u>Monthly Model Lease Amount</u>	<u>Number of Model Homes</u>
Texas	\$ 56,700	41,300	\$ 53,002	58
Arizona	71,700	32,600	130,028	64
California	15,000	7,400	52,720	38
Nevada	8,900	7,000	22,533	19
Corporate	9,200	4,500	--	--
Total	<u>\$ 161,500</u>	<u>92,800</u>	<u>\$ 258,283</u>	<u>179</u>

Item 3. Legal Proceedings

We are involved in various routine legal proceedings incidental to our business, some of which are covered by insurance. With respect to all pending litigation matters, our ultimate legal and financial responsibility, if any, cannot be estimated with certainty and, in most cases, any potential losses related to these matters are not considered probable. We have accrued approximately \$937,000 for losses related to potential litigation where our ultimate exposure is considered probable and the potential loss can be reasonably estimated, which is classified in accrued liabilities on our December 31, 2002 balance sheet. We believe that none of these matters will have a material adverse impact upon our consolidated financial condition, results of operations or cash flows.

Item 4. Submission of Matters to a Vote of Security Holders

We did not submit any matters to a vote of stockholders during the fourth quarter of 2002.

PART II

Item 5. Market For the Registrant's Common Stock and Related Stockholder Matters

General

Our common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "MTH." The high and low sales prices of the common stock for the periods indicated, as reported by the NYSE, follow. All amounts reflect a 2-for-1 stock split in the form of a stock dividend that occurred in April 2002.

	<u>2002</u>		<u>2001</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
First Quarter	\$ 35.12	\$ 23.28	\$ 24.00	\$ 13.70
Second Quarter	\$ 47.10	\$ 31.22	\$ 26.88	\$ 13.05
Third Quarter	\$ 46.25	\$ 26.38	\$ 29.98	\$ 13.75
Fourth Quarter	\$ 42.20	\$ 28.90	\$ 26.49	\$ 17.00

On March 14, 2003, the closing sales price of the common stock as reported by the NYSE was \$32.31 per share. At that date, there were approximately 213 owners of record. There are approximately 3,200 beneficial owners of common stock.

The transfer agent for our common stock is Mellon Investor Services LLC, 85 Challenger Road, Ridgefield Park, NJ 07660. (www.melloninvestor.com)

We did not declare cash dividends in 2002, 2001 or 2000, nor do we intend to declare cash dividends in the foreseeable future. Earnings will be retained to finance the continuing development of the business. Future cash dividends, if any, will depend upon our financial condition, results of operations, capital requirements, compliance with debt covenants, as well as other factors considered relevant by our Board of Directors.

Factors That May Affect Future Stock Performance

The performance of our common stock depends upon many factors, including those listed below and in "Management's Discussion and Analysis of Financial Condition and Results of Operations – Factors That May Affect Our Future Results and Financial Condition."

The market price of our common stock could be subject to significant fluctuations in response to certain factors, such as variations in anticipated or actual results of our operations or that of other homebuilding companies, changes in conditions affecting the general economy, war or other hostilities involving the United States, including the armed conflict with Iraq, widespread industry trends and analysts' reports, changes in interest rates, as well as other factors unrelated to our operating results.

Item 6. Selected Financial Data

The following table presents selected historical consolidated financial and operating data of Meritage Corporation and subsidiaries as of and for each of the last five years ended December 31, 2002. The financial data has been derived from our consolidated financial statements and related notes audited by KPMG LLP, independent auditors. For additional information, see the consolidated financial statements included elsewhere in this Annual Report on Form 10-K. The following table should be read in conjunction with Management's Discussion and Analysis of Financial Condition and the Results of Operations. These historical results may not be indicative of future results.

The data below includes the operations of Meritage Homes of California, Hancock Communities, Hammonds Homes and Perma-Bilt Homes since their respective dates of acquisition. Those dates are: Meritage Homes of California, acquired July 1998; Hancock Communities, acquired May 2001; Hammonds Homes, acquired July 2002; and Perma-Bilt Homes, acquired October 2002.

Historical Consolidated Financial Data Years Ended December 31, (\$ in thousands, except per share amounts)					
	2002	2001	2000	1999	1998
Statement of Earnings Data:					
Total sales revenue	\$ 1,119,817	\$ 744,174	\$ 520,467	\$ 341,786	\$ 257,113
Total cost of sales	<u>(904,921)</u>	<u>(586,914)</u>	<u>(415,649)</u>	<u>(277,287)</u>	<u>(205,188)</u>
Gross profit	214,896	157,260	104,818	64,499	51,925
Earnings from mortgage assets and other income, net ⁽¹⁾	5,435	2,884	1,847	2,064	3,961
Commissions and other sales costs	(65,291)	(41,085)	(28,680)	(19,243)	(14,292)
General and administrative expenses	(41,496)	(35,723)	(21,215)	(15,100)	(10,632)
Interest expense	<u>—</u>	<u>—</u>	<u>(8)</u>	<u>(6)</u>	<u>(462)</u>
Earnings before income taxes and extraordinary items	113,544	83,336	56,762	32,214	30,500
Income taxes ⁽²⁾	(43,607)	(32,444)	(21,000)	(13,269)	(6,497)
Extraordinary items, net of tax effects ⁽³⁾	<u>—</u>	<u>(233)</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net earnings	<u>\$ 69,937</u>	<u>\$ 50,659</u>	<u>\$ 35,762</u>	<u>\$ 18,945</u>	<u>\$ 24,003</u>
Net earnings per common share:^{(4) (5)}					
Basic	\$ 5.64	\$ 4.78	\$ 3.46	\$ 1.75	\$ 2.26
Diluted	\$ 5.31	\$ 4.30	\$ 3.13	\$ 1.57	\$ 1.96
Balance Sheet Data (end of year):					
Real estate	\$ 484,970	\$ 330,238	\$ 211,307	\$ 171,012	\$ 104,759
Total assets	691,788	436,715	267,075	226,559	152,250
Notes payable	264,927	177,561	86,152	85,937	37,205
Total liabilities	374,480	260,128	145,976	136,148	79,971
Stockholders' equity	317,308	176,587	121,099	90,411	72,279

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
Supplemental Financial Data:					
Cash provided by (used in):					
Operating activities	\$ (5,836)	\$ (17,137)	\$ 6,252	\$ (36,387)	\$ (2,366)
Investing activities	(142,805)	(75,739)	(8,175)	(9,902)	(3,928)
Financing activities	151,858	91,862	(7,102)	47,324	10,436

- (1) Earnings from mortgage assets that were obtained from our predecessor and disposed of in 1998 are applicable only to that year.
- (2) Prior to the full utilization in 1998 of our net operating loss carryforward obtained from our predecessor, we paid limited income taxes.
- (3) The 2001 amount reflects the net effect of extraordinary items from early extinguishments of long-term debt.
- (4) 2001 earnings per share are shown after a \$0.02 loss from the extraordinary items. Basic and diluted earnings per share before the extraordinary items were \$4.80 and \$4.32, respectively. We did not pay cash dividends in the years 1998 through 2002.
- (5) All amounts reflect a 2-for-1 stock split in the form of a stock dividend that occurred in April 2002.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America.

Critical Accounting Policies

We have established various accounting policies which govern the application of accounting principles generally accepted in the United States of America in the preparation and presentation of our consolidated financial statements. Our significant policies are described in Note 1 of the consolidated financial statements. Certain accounting policies involve significant judgments, assumptions and estimates by management that have a material impact on the carrying value of certain assets and liabilities, and revenues and costs which we consider to be critical accounting policies. The judgments, assumptions and estimates we use are based on historical experience, knowledge of the accounts and other factors which we believe to be reasonable under the circumstances, and we evaluate our judgments and assumptions on an on-going basis. Because of the nature of the judgments and assumptions we have made, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of our operations.

The accounting policies that we deem most critical to us, and involve the most difficult, subjective or complex judgments, include our estimates of costs to complete our individual projects, the ultimate recoverability (or impairment) of these costs, goodwill impairment, the likelihood of closing lots held under option or contract and the ability to estimate expenses and accruals, including legal and warranty reserves. Should we under or over estimate costs to complete individual projects, gross margins in a particular period could be misstated and the ultimate recoverability of costs related to a project from home sales may be uncertain. Furthermore, non-refundable deposits paid for land options or contracts may have no economic value to us if we do not ultimately purchase the land. Our inability to accurately estimate expenses, accruals, or an impairment of real estate or goodwill could result in charges, or income, in future periods, which relate to activities or transactions in a preceding period.

We acquired Hancock Communities (Hancock), a homebuilder in the Phoenix, Arizona metropolitan area, effective May 31, 2001, Hammonds Homes, a builder in Houston, Austin and Dallas, Texas, effective July 1, 2002, and Perma-Bilt Homes, which builds in the Las Vegas, Nevada area, effective October 1, 2002. The results presented below include the operations of these three acquisitions since their dates of purchase and are not necessarily indicative of results to be expected in the future.

Home Sales Revenue, Sales Contracts and Net Sales Backlog

The tables provided below show operating and financial data regarding our homebuilding activities (dollars in thousands).

	<u>Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Home Sales Revenue			
<u>Total</u>			
Dollars	\$ 1,112,439	\$ 742,576	\$ 515,428
Homes closed	4,574	3,270	2,227
Average sales price	\$ 243.2	\$ 227.1	\$ 231.4
<u>Texas</u>			
Dollars	\$ 387,264	\$ 259,725	\$ 214,472
Homes closed	2,090	1,518	1,239
Average sales price	\$ 185.3	\$ 171.1	\$ 173.1
<u>Arizona</u>			
Dollars	\$ 445,275	\$ 325,918	\$ 175,674
Homes closed	1,735	1,343	623
Average sales price	\$ 256.6	\$ 242.7	\$ 282.0
<u>California</u>			
Dollars	\$ 245,640	\$ 156,933	\$ 125,282
Homes closed	594	409	365
Average sales price	\$ 413.5	\$ 383.7	\$ 343.2
<u>Nevada</u>			
Dollars	\$ 34,260	--	--
Homes closed	155	--	--
Average sales price	\$ 221.0	--	--
Sales Contracts			
<u>Total</u>			
Dollars	\$ 1,161,899	\$ 700,104	\$ 604,444
Homes ordered	4,504	3,016	2,480
Average sales price	\$ 258.0	\$ 232.1	\$ 243.7
<u>Texas</u>			
Dollars	\$ 417,158	\$ 255,811	\$ 240,054
Homes ordered	2,134	1,516	1,368
Average sales price	\$ 195.5	\$ 168.7	\$ 175.5
<u>Arizona</u>			
Dollars	\$ 383,445	\$ 309,170	\$ 196,567
Homes ordered	1,425	1,165	643
Average sales price	\$ 269.1	\$ 265.4	\$ 305.7
<u>California</u>			
Dollars	\$ 329,252	\$ 135,123	\$ 196,567
Homes ordered	794	335	469
Average sales price	\$ 414.7	\$ 403.4	\$ 357.8

	<u>Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
<u>Nevada</u>			
Dollars	\$ 32,044	--	--
Homes ordered	151	--	--
Average sales price	\$ 212.2	--	--
Net Sales Backlog			
<u>Total</u>			
Dollars	\$ 537,764	\$ 374,951	\$ 309,901
Homes in backlog	2,070	1,602	1,246
Average sales price	\$ 259.8	\$ 234.1	\$ 248.7
<u>Texas</u>			
Dollars	\$ 218,899	\$ 115,651	\$ 119,564
Homes in backlog	1,085	693	695
Average sales price	\$ 201.8	\$ 166.9	\$ 172.0
<u>Arizona</u>			
Dollars	\$ 144,155	\$ 205,985	\$ 115,211
Homes in backlog	466	776	344
Average sales price	\$ 309.3	\$ 265.4	\$ 334.9
<u>California</u>			
Dollars	\$ 136,927	\$ 53,315	\$ 75,126
Homes in backlog	333	133	207
Average sales price	\$ 411.2	\$ 400.9	\$ 362.9
<u>Nevada</u>			
Dollars	\$ 37,783	--	--
Homes in backlog	186	--	--
Average sales price	\$ 203.1	--	--

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Home Sales Revenue. The increases in total home sales revenue in 2002 compared to 2001 resulted mainly from a 40% increase in the number of homes closed and an increase in our average sales price from \$227,100 in 2001 to \$243,200 in 2002. The number of closings increased as a result of continued growth in our mid-priced communities in Arizona and growth from the acquisitions of Hammonds and Perma-Bilt. The number of homes closed in Texas during 2002 included 442 Hammonds closings. The increases were offset to some degree by decreases in closings in our Austin division due to an overall weaker economy in that market and in Monterey Phoenix because of a slowing in demand for our luxury priced homes.

Sales Contracts. Sales contracts for any period represent the aggregate sales price of all homes ordered by customers, net of cancellations. We do not include sales contingent upon the sale of a customer's existing home as a sales contract until the contingency is removed. Contributing to the increase in sales contracts for the year 2002 from the previous year were the addition of the Hammonds and Perma-Bilt operations along with strong markets in 2002. The number of new orders in Texas during 2002 includes 466 orders from our Hammonds operations. As a whole, we benefited from positive demographic factors, historically high home ownership rates, relatively low mortgage interest rates and generally low unemployment figures. We saw declines in new orders in our Monterey Phoenix and Austin divisions in 2002, which we believe is due to a slowing in demand for luxury homes in Phoenix and a weaker local economy in Austin. Historically, we have experienced a cancellation rate of approximately 25% of gross sales, which we believe is consistent with industry norms.

Net Sales Backlog. Backlog represents net sales contracts that have not closed. Total dollar backlog at December

31, 2002 increased 43% over the 2001 amount due to a 29% increase in the number of homes in backlog, and an 11% increase in the average sales prices of those homes. The increase in the number of homes resulted mainly from our acquisitions, which contributed 558 homes with a sales value of approximately \$117.3 million to our December 31, 2002 backlog. Backlog in our Monterey Phoenix and Austin divisions decreased in 2002 due to a slowing in demand for luxury homes in Phoenix and a weaker local economy in Austin.

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Home Sales Revenue. The increases in total home sales revenue and the number of homes closed in 2001 compared to 2000 resulted mainly from the strong market activity at the time the orders for these closings were taken in some of our divisions, continued growth in our mid-priced communities in Arizona and the May 2001 addition of Hancock to our Phoenix operations. These increases were somewhat offset by decreases in closings in our Monterey Phoenix and Austin divisions in 2001, due to weaker demand in the luxury price segment and a weaker local economy, respectively. Hancock contributed 673 closings with a sales value of approximately \$122.5 million to our 2001 results. The decreases in average home sales prices in Arizona for the year 2001 reflect a change in our product mix, as we are now selling more first-time and first and second time move-up homes than in 2000, due in large part to the Hancock acquisition.

Sales Contracts. As a whole, we benefited from low mortgage interest rates, generally low employment figures and improved home affordability in 2001. Contributing to the increase in sales contracts for the year 2001 from the previous year were 484 new contracts from the Hancock acquisition along with strong markets early in the year. As a whole, we benefited from low mortgage interest rates, generally low unemployment figures and improved home affordability early in 2001. We saw declines in new orders in our Monterey Phoenix, Northern California and Austin divisions in 2001, and believe this is due to a slowing in demand for luxury homes and weaker local economies in the Northern California and Austin markets.

Net Sales Backlog. Total dollar backlog at December 31, 2001 increased 21% over the 2000 amount due to a 29% increase in the number of homes in backlog from increased home sales over last year and increased sales prices in some of our markets. The increase in the number of homes resulted mainly from our Hancock acquisition, which contributed 421 homes with a sales value of approximately \$84.9 million to our December 31, 2001, backlog. Backlog in our Monterey Phoenix, Northern California and Austin divisions decreased in 2001 due to a slowing in demand for higher-priced homes and weaker local economies in the Northern California and Austin markets.

Other Operating Information

	<u>Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u> <u>(\$ in thousands)</u>	<u>2000</u>
Home Sales Gross Profit			
Dollars	\$ 214,096	\$ 157,136	\$ 104,225
Percent of home sales revenue	19.3%	21.2%	20.2%
Commissions and Other Sales Costs			
Dollars	\$ 65,291	\$ 41,085	\$ 28,680
Percent of home sales revenue	5.9%	5.5%	5.6%
General and Administrative Expenses			
Dollars	\$ 41,496	\$ 35,723	\$ 21,215
Percent of total revenue	3.7%	4.8%	4.1%
Income Taxes			
Dollars	\$ 43,607	\$ 32,444	\$ 21,000
Percent of earnings before income taxes and extraordinary items	38.4%	38.9%	37.0%

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Home Sales Gross Profit. Home sales gross profit represents home sales revenue less cost of home sales. Cost of home sales include developed lot costs, direct home construction costs, an allocation of common community costs (such

as model complex costs and architectural, legal and zoning costs), interest, sales tax, warranty, construction overhead and closing costs. The dollar increase in gross profit for the year ended December 31, 2002, is attributable to the 40% increase in home sales revenue for reasons previously described in that section of management's discussion and analysis of financial condition and results of operations. The gross profit margin on home sales decreased to 19.3% in 2002, primarily due to the effect of writing up certain assets acquired in conjunction with purchase accounting for the Hammonds and Perma-Bilt acquisitions. This effectively increased cost of sales by \$5.5 million in the current year, due to the lower gross profit margins generally achieved by Hammonds in comparison to the Company as a whole and to increased competitive pressures in some of our markets.

Land Sales. The sale of land is not a significant component of our business plan and takes place infrequently. During 2002 we sold three parcels of land in Arizona at a price of \$7.4 million, resulting in a gross profit of \$800,000. During 2001, land sales of \$1.6 million provided gross profit of \$124,000 and resulted from the sales of lots in Texas and Arizona.

Commissions and Other Sales Costs. Commissions and other sales costs, such as advertising and sales office expenses, were approximately \$65.3 million, or 5.9% of home sales revenue in 2002, as compared to approximately \$41.1 million, or 5.5% of home sales revenue in 2001. The increase in these expenses as a percentage of home sales revenue reflects marketing costs in some of our communities that were not yet closing homes in 2002.

General and Administrative Expenses. General and administrative expenses were approximately \$41.5 million, or 3.7% of total revenue in 2002, as compared to approximately \$35.7 million, or 4.8% of total revenue in 2001. The lower expense as a percentage of total revenue in 2002 in comparison to 2001 resulted partly from the June 2002 end to the California earn-out payment per the terms of the purchase contract when we acquired the division. The earn-out was based on 20% of the pre-tax earnings of the Northern California region after reduction for a capital charge. Company-wide, we were also able to benefit from expanding revenue while holding down increases in overhead costs.

Other Income. Other income consists primarily of mortgage company income, forfeiture of customer deposits, management fees and rebates made under volume based purchasing programs.

The increase in other income from the year ended December 31, 2001 to the year ended December 31, 2002 is primarily due to increased volume in all of our divisions, resulting in additional income, fees and forfeitures of approximately \$2.5 million.

Income Taxes. The increase in income taxes to \$43.6 million for the year ended December 31, 2002, from \$32.4 million in the prior year resulted from an increase in pre-tax income. The tax benefit associated with the exercise of employee stock options reduced taxes currently payable by approximately \$5.2 million for the year ended December 31, 2002, which resulted in a more favorable tax rate. The tax benefit was credited to additional paid-in capital.

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Home Sales Gross Profit. The dollar increase in gross profit for the year ended December 31, 2001, was attributable to the 44% increase in home sales revenue for reasons previously described in that section of management's discussion and analysis of financial condition and results of operations. Home sales gross margins expanded to 21.2% due in part to the strong housing demand in late 2000 and early 2001, which is the period when many of the purchase contracts for homes closed in 2001 were entered into with our customers. We were also able to benefit from a reasonably favorable market for home construction materials, which resulted in lower construction cost increases than had incurred in prior years.

Commissions and Other Sales Costs. Commissions and other sales costs were approximately \$41.1 million, or 5.5% of home sales revenue in 2001, as compared to approximately \$28.7 million, or 5.6% of home sales revenue in 2000. The slight decrease in these expenses as a percentage of home sales revenue reflected greater efficiencies in controlling costs.

General and Administrative Expenses. General and administrative expenses were approximately \$35.7 million, or 4.8% of total revenue in 2001, as compared to approximately \$21.2 million, or 4.1% of total revenue in 2000. The higher expense as a percentage of total revenue in 2001 in comparison to 2000 resulted from an increase in insurance

costs and the increased overhead related to our Hancock acquisition. In addition, the increase in the number of closings in our Northern California region in 2001 resulted in a greater earn-out payment per the terms of the purchase contract. The earn-out was calculated based on 20% of the pre-tax earnings of the Northern California region after reduction for a capital charge.

Income Taxes. The increase in income taxes to \$32.4 million for the year ended December 31, 2001, from \$21.0 million in the prior year resulted from an increase in pre-tax income. The tax benefit associated with the exercise of employee stock options reduced taxes payable by approximately \$2.5 million for the year ended December 31, 2001, which resulted in a more favorable tax rate. The tax benefit was credited to additional paid-in capital.

Liquidity and Capital Resources

Our principal uses of capital for the year ended December 31, 2002 were operating expenses, land purchases, lot development, home construction, the repurchase of common stock, and the acquisition of Hammonds and Perma-Bilt. We used a combination of borrowings and funds generated by operations to meet our short-term working capital requirements and in June 2002 we completed an equity offering, resulting in net proceeds of approximately \$80 million, in order to meet long-term capital requirements.

Cash flows for each of our communities depends on the status of the development cycle, and can differ substantially from reported earnings. Early stages of development or expansion require significant cash outlays for land acquisitions, plat and other approvals, and construction of model homes, roads, utilities, general landscaping and other amenities. Because these costs are capitalized, income reported for financial statement purposes during those early stages may significantly exceed cash flow. Later cash flows may significantly exceed earnings reported for financial statement purposes, as cost of sales includes charges for substantial amounts of previously expended costs.

In December 2002 we entered into a credit agreement which provides for a \$250 million senior unsecured revolving credit facility with a \$40 million letter of credit sublimit. Guaranty Bank is the administrative agent for the facility, which matures on December 12, 2005, subject to extension provisions. The new senior unsecured credit facility replaced our two secured credit facilities totaling \$190 million, of which approximately \$123 million was outstanding when they were repaid on December 12, 2002. These credit agreements were repaid with the initial loan proceeds of the unsecured facility.

At December 31, 2002, \$107.6 million of borrowings were outstanding under our senior unsecured revolving credit facility, with unborrowed availability under the bank credit facility of approximately \$86.0 million.

This credit facility contains certain financial and other covenants, including:

- requiring the maintenance of tangible net worth;
- requiring the maintenance of a minimum interest coverage ratio;
- establishing a maximum permitted total leverage ratio;
- imposing limitations on the incurrence of additional indebtedness and liens;
- imposing restrictions on investments, dividends and certain other payments;
- imposing restrictions on sale and leaseback transactions and the incurrence of off-balance sheet liabilities; and
- imposing limitations on the maximum net book value of specified land holdings as a percentage of consolidated tangible net worth.

As of and for the year ended December 31, 2002, we were in compliance with these covenants.

In May 2001, we issued \$165 million in principal amount of 9.75% senior notes due June 1, 2011. Approximately \$66 million of this offering was used to complete the acquisition of Hancock, approximately \$78 million was used to pay down existing bank debt, approximately \$5.1 million was used to pay costs related to the senior notes offering and approximately \$15.9 million was used to repay previously existing senior notes. This early repayment of debt resulted in prepayment fees of approximately \$731,000, which, net of the related income tax benefit, resulted in an extraordinary loss of approximately \$445,000 in the second quarter of 2001.

In September 2001, we purchased and retired \$10 million in principal amount of our outstanding 9.75% senior notes. The purchases were made at 93.25% of par at a gain of approximately \$348,000, which net of related income tax effect of \$136,000, resulted in an extraordinary gain of \$212,000.

In February 2003, we completed an add-on offering of \$50 million in aggregate principal amount of our 9.75% senior notes due June 1, 2001, the proceeds of which were used to pay down our senior unsecured credit facility. The notes were issued at a price of 103.25% of their face amount to yield 9.054%, and together with the May 2001 offering, constitute a single series of notes.

Our senior notes require us to comply with a number of covenants that restrict certain transactions, including:

- limitations on additional indebtedness;
- limitations on the payment of dividends, redemption of equity interests and certain investments;
- maintenance of a minimum level of consolidated tangible net worth;
- limitations on liens securing certain obligations; and
- limitations on the sale of assets, mergers and consolidations and transactions with affiliates.

As of and for the year ended December 31, 2002, we were in compliance with these covenants.

We believe that our current borrowing capacity, cash on hand at December 31, 2002, and anticipated net cash flows from operations are and will be sufficient to meet liquidity needs for the foreseeable future. There is no assurance, however, that future cash flows will be sufficient to meet future capital needs. The amount and types of indebtedness that we incur may be limited by the terms of the indenture governing our senior notes and by the terms of the credit agreement governing our senior unsecured credit facility.

In May 1999, we announced a stock repurchase program in which our Board of Directors approved the buyback of up to \$6 million of our outstanding common stock, and in July 2001 this amount was increased to \$20 million. In August 2002, we announced a second stock repurchase program in which the board of directors approved the buyback of up to \$32 million of our outstanding stock. In 2002, we repurchased 500,000 shares of our common stock at an average price of \$34.30 per share. Under both programs, we had repurchased 2,137,926 shares for an aggregate price of approximately \$28.4 million as of December 31, 2002.

Contractual Obligations

The following summarizes our contractual obligations at December 31, 2002, and the effect such obligations are expected to have on our liquidity and cash flows in future periods (in thousands):

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Senior notes	\$ 155,000	--	--	--	\$ 155,000
Revolving construction facilities	107,565	\$ 107,565	--	--	--
Other borrowing obligations	2,362	1,808	\$ 554	--	--
Operating lease obligations	7,127	3,645	3,463	\$ 19	--
Recourse option obligations	30,915	22,214	8,701	--	--
Total	<u>\$ 302,969</u>	<u>\$ 135,232</u>	<u>\$ 12,718</u>	<u>\$ 19</u>	<u>\$ 155,000</u>

We do not engage in commodity trading or other similar activities. We had no derivative financial instruments at December 31, 2002 or 2001.

As a part of our model home construction activities, we enter into lease transactions with third parties. The total cost, including land, and construction costs of model homes leased by us under these lease agreements is \$38.6 million, all of which is excluded from our balance sheet as of December 31, 2002. Our rent obligations under these leases are

included in the table above within operating lease obligations. See Notes 2 and 11 to our consolidated financial statements included in this report for additional information regarding our contractual obligations

Letter of Credit and Bond Obligations

We obtain letters of credit, mainly in lieu of cash deposits to support our option agreements, and performance, maintenance, and other bonds in support of our related obligations with respect to the development of our projects. The amount of these obligations outstanding at any time varies in accordance with pending development activities. In the event the letters of credit or bonds are drawn upon, we would be obligated to reimburse the issuer of the letter of credit or bond. At December 31, 2002, we had approximately \$16.2 million in outstanding letters of credit and \$72.9 million in performance bonds for such purposes. We do not believe it is probable that any of these letters of credit or bonds will be drawn upon.

Consolidated Cash Flow

Our cash and cash equivalents at December 31, 2002 increased by \$3.2 million from the balance at the end of the prior year. This increase reflects a net usage of cash in operating activities of \$5.8 million and investing activities of \$142.8 million, offset by increases resulting from financing activities of \$151.9 million. Our main uses of cash for investing activities were for our acquisitions of Hammonds and Perma-Bilt which totaled \$129.6 million, while our main sources of cash from financing activities were net borrowings under our credit facilities of \$86.3 million and the proceeds from our common stock offering in June 2002 of \$79.7 million, which was offset by \$17.2 million of cash used for repurchases of our common stock.

We used cash in operations of \$5.8 million in 2002, compared with \$17.1 million in 2001. Net cash provided by operating activities in 2000 was \$6.3 million. The decrease in cash used in operations in 2002 resulted mainly from the \$19.3 million increase in net earnings. The change in cash used of \$17.1 million in 2001 over \$6.3 million provided in 2000 resulted from increases in our real estate, option deposits and homebuilding assets in conjunction with our increased homebuilding operations.

We used cash in investing activities of \$142.8 million in 2002, compared with \$75.7 million and \$8.2 million in 2001 and 2000, respectively. The increase in cash used in 2002 over 2001 was primarily due to our acquisition of Hammonds and Perma-Bilt, which used cash of approximately \$129.6 million. The increase in cash used in 2001 over 2000 was primarily due to our acquisition of Hancock, which used cash of approximately \$66 million.

Financing activities generated cash of \$151.9 million in 2002 and \$91.9 million in 2001. In 2000 we used \$7.1 million in cash from financing activities. The increase in cash provided by financing activities in 2002 resulted mainly from the proceeds from the sale of our common stock in a public offering, offset by increased purchases of treasury shares. The increase in cash generated in 2001 over 2000 mainly was due to the issuance of our 9.75% senior notes. In 2000, we did not engage in any significant capital raising activities other than the borrowing and repayment of our credit facilities and we used \$9.1 million to acquire treasury shares.

Seasonality

We historically have closed more homes in the second half of the fiscal year than in the first half, due in part to the slightly seasonal nature of the market for our move-up and semi-custom luxury products. We expect this seasonal trend to continue, although it may vary as our operations continue to expand.

New Accounting Standards

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities". This interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", addresses consolidation by business enterprises of variable interest entities (selected entities with related contractual, ownership, voting or other monetary interests, including certain special purpose entities), and requires certain additional disclosure with respect to these entities. The provisions of FIN 46 are applicable immediately to variable interest entities created after January 31, 2003. A public entity with a variable interest in a variable interest

entity created before February 1, 2003, shall apply the provisions of FIN 46 to that entity no later than the beginning of the first interim or annual reporting period beginning after June 15, 2003. We do not expect the requirements of FIN 46 to have a material impact on our consolidated financial statements.

In December 2002, the FASB issued Statement of Financial Accounting Standards (SFAS) 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." This amendment to FASB Statement No. 123 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of FASB Statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The provisions of this statement are effective for financial statements of interim or annual periods after December 15, 2002. We do not intend to change to the fair value method of accounting. The required disclosures are included in the stock-based compensation section of Note 1 to the consolidated financial statements appearing in this document.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This interpretation expands the disclosures to be made by a guarantor in its financial statements about its obligations under certain guarantees and requires the guarantor to recognize a liability for the fair value of an obligation assumed under a guarantee. FIN 45 clarifies the requirements of SFAS No. 5, "Accounting for Contingencies," relating to guarantees. In general, FIN 45 applies to contracts or indemnification agreements that contingently require the guarantor to make payments to the guaranteed party based on changes that are related to an asset, liability, or equity security of the guaranteed party. Certain guarantee contracts are excluded from both the disclosure and recognition requirements of this interpretation, including, among others, guarantees relating to employee compensation, residual value guarantees under capital lease arrangements, commercial letters of credit, loan commitments, subordinated interests in a special purpose entity, and guarantees of a company's own performance. Other guarantees are subject to the disclosure requirements of FIN 45 but not to the recognition provisions and include, among others, a guarantee accounted for as a derivative instrument under SFAS 133, a parent's guarantee of debt owed to a third party by its subsidiary or vice versa, and a guarantee which is based on performance, not price. The disclosure requirements of FIN 45 are effective for the Company as of December 31, 2002 and require disclosure of the nature of the guarantee, the maximum potential amount of future payments that the guarantor could be required to make under the guarantee, and the current amount of the liability, if any, for the guarantor's obligations under the guarantee. The recognition requirements of FIN 45 are to be applied prospectively to guarantees issued or modified after December 31, 2002. We do not expect the requirements of FIN 45 to have a material impact on our consolidated financial statements. For disclosures required by FIN 45 see Note 11, "Commitments and Contingencies" in the consolidated financial statements appearing in this document.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets," that supersedes APB Opinion No. 17. Under SFAS 142, goodwill and intangible assets deemed to have indefinite lives are no longer amortized, but are to be reviewed at least annually for impairment, under impairment guidelines established in the statement. SFAS 142 also changes the amortization methodology in intangible assets that are deemed to have finite lives and adds to required disclosures regarding goodwill and intangible assets. SFAS 142 is effective for fiscal years beginning after December 15, 2001. We adopted SFAS 142 on January 1, 2002, and our unamortized balance of goodwill as of that date was approximately \$30.4 million. Beginning in 2002, we ceased our amortization of goodwill. Goodwill amortization for 2001 and 2000 was approximately \$1.4 million and \$1.1 million, respectively. During 2002, under guidelines contained in the statement, management performed an analysis concerning potential impairment of the goodwill carried and determined that no impairment existed. A subsequent assessment is being performed in the first quarter of 2003, and to date, no impairment has been found to exist. See Note 1 and Note 4 to the consolidated financial statements appearing in this document for further discussion of SFAS 142.

Factors That May Affect Our Future Results and Financial Condition

Future operating results and financial condition depend on our ability to successfully design, develop, construct and sell homes that satisfy dynamic customer demand patterns. Inherent in this process are factors that we must successfully manage to achieve favorable future operating results and financial condition. These operating and financial factors, along with many other factors, could affect the price of our common stock and notes. Potential risks and uncertainties that could affect future operating results and financial condition could include the factors discussed below.

Homebuilding industry factors. The homebuilding industry is cyclical and is significantly affected by changes in economic and other conditions, such as employment levels, availability of financing, interest rates, and consumer confidence. These factors can negatively affect the demand for and pricing of our homes. We are also subject to various risks, many of which are outside our control, including delays in construction schedules, cost overruns, changes in governmental regulations (such as no- or slow-growth initiatives), increases in real estate taxes and other local government fees, and raw materials and labor costs.

We are also subject to the potential for significant variability and fluctuations in the cost and availability of real estate. Write-downs of our land inventories could occur if market conditions deteriorate and these write-downs could be material in amount. Although historically we have generally developed parcels ranging from 100 to 300 lots, in order to achieve and maintain an adequate inventory of lots, we are beginning to purchase larger parcels, in some cases with a joint venture partner. Write-downs may also occur if we purchase land at higher prices during stronger economic periods and the value of that land subsequently declines during slower economic periods.

Home warranty factors. Construction defect and home warranty claims are common in the homebuilding industry and can be costly. While we maintain product liability insurance and generally require our subcontractors and design professionals to indemnify us for liabilities arising from their work, we cannot assure you that these insurance rights and indemnities will be adequate to cover all construction defect and warranty claims for which we may be held liable. For example, we may be responsible for applicable self-insured retentions, which have increased recently, and certain claims may not be covered by insurance or may exceed applicable coverage limits.

Increased insurance costs. Recently, lawsuits have been filed against builders asserting claims of personal injury and property damage caused by the presence of mold in residential dwellings. Some of these lawsuits have resulted in substantial monetary judgments or settlements. We believe that we have maintained adequate insurance coverage to insure against these types of claims. We believe it is possible that in the future insurance carriers may exclude claims from future policies arising from the presence of mold or such coverage may become prohibitively expensive. If we are unable to obtain adequate insurance coverage, a material adverse effect on our business, financial condition and results of operations could result if we are exposed to claims arising from the presence of mold in the homes that we sell.

Partially as a result of the September 11, 2001 terrorist attacks, the cost of insurance has risen, deductibles or retentions have increased and the availability of insurance has diminished. Significant increase in our cost of insurance coverage or retentions could have a material adverse effect on our business, financial condition and results of operations.

Fluctuations in operating results. We historically have experienced, and expect to continue to experience, variability in home sales and net earnings on a quarterly basis. As a result of such variability, our historical performance may not be a meaningful indicator of future results. Factors that contribute to this variability include:

- timing of home deliveries and land sales;
- our ability to acquire additional land or options for additional land on acceptable terms;
- conditions of the real estate market in areas where we operate and of the general economy;
- the cyclical nature of the homebuilding industry, changes in prevailing interest rates and the availability of mortgage financing;
- costs and availability of materials and labor; and
- delays in construction schedules due to strikes, adverse weather, acts of God, reduced subcontractor availability and governmental restrictions.

Interest Rates and Mortgage Financing. In general, housing demand is adversely affected by increases in interest rates and housing costs and the unavailability of mortgage financing. Most of our buyers finance their home purchases through third-party lenders providing mortgage financing. If mortgage interest rates increase and, consequently, the ability of prospective buyers to finance home purchases is adversely affected, home sales, gross margins and cash flow may also be adversely affected and the impact may be significant. Interest rates are currently at historically low levels and, while it is impossible to predict future increases or decreases in market interest rates, we do not expect current rates to remain indefinitely at their current levels. In addition, homebuilding activities depend upon the availability and costs of mortgage financing for buyers of homes owned by potential customers, as those customers (move-up buyers) often

need to sell their residences before they purchase our homes. Any reduction of financing availability could adversely affect home sales.

Competition. The homebuilding industry is highly competitive. We compete for sales in each of our markets with national, regional and local developers and homebuilders, existing home resales and, to a lesser extent, condominiums and available rental housing. If we are unable to successfully compete, our financial results and growth could suffer. Some of our competitors have significantly greater financial resources or lower costs than we do. Competition among both small and large residential homebuilders is based on a number of interrelated factors, including location, reputation, amenities, design, quality and price. Competition is expected to continue and become more intense, and there may be new entrants in the markets in which we currently operate and in markets we may enter in the future.

Lack of Geographic Diversification. We have operations in Texas, Arizona, Northern California and Nevada. Our lack of geographic diversification could adversely impact us if the homebuilding business in our current markets should decline, since there may not be a balancing opportunity in a stronger market in other geographic regions.

Additional Financing; Limitations. The homebuilding industry is capital intensive and requires significant up-front expenditures to acquire land and begin development. Accordingly, we incur substantial indebtedness to finance our homebuilding activities. At December 31, 2002, our debt totaled approximately \$264.9 million. We may be required to seek additional capital in the form of equity or debt financing from a variety of potential sources, including bank financing and securities offerings. The level of our indebtedness could have important consequences to our stockholders, including the following:

- our ability to obtain additional financing for working capital, capital expenditures, acquisitions or general corporate purposes may be impaired;
- we must use a substantial portion of our cash flow from operations to pay interest and principal on our indebtedness, which will reduce the funds available to use for other purposes such as capital expenditures;
- we have a higher level of indebtedness than some of our competitors, which may put us at a competitive disadvantage and reduce our flexibility in planning for, or responding to, changing conditions in our industry, including increased competition; and
- we are more vulnerable to economic downturns and adverse developments in our business.

We expect to obtain the money to pay our expenses and to pay the principal and interest on our indebtedness from cash flow from operations. Our ability to meet our expenses thus depends on our future performance, which will be affected by financial, business, economic and other factors. We will not be able to control many of these factors, such as economic conditions in the markets where we operate and pressure from competitors. We cannot be certain that our cash flow will be sufficient to allow us to pay principal and interest on our debt and meet our other obligations. If we do not have sufficient funds, we may be required to refinance all or part of our existing debt, sell assets or borrow more money. We cannot guarantee that we will be able to do so on terms acceptable to us, if at all. In addition, the terms of existing or future debt agreements may restrict us from pursuing any of these alternatives.

Operating and Financial Limitations. The indenture for our senior notes and the agreement for our senior unsecured credit facility impose significant operating and financial restrictions on us. These restrictions will limit our ability, among other things, to:

- incur additional indebtedness;
- pay dividends or make other distributions;
- repurchase our stock;
- make investments;
- sell assets;
- enter into agreements restricting our subsidiaries' ability to pay dividends;
- enter into transactions with affiliates; and
- consolidate, merge or sell all or substantially all of our assets.

In addition, the indenture for our senior notes requires us to maintain a minimum consolidated tangible net worth and our senior unsecured credit facility requires us to maintain other specified financial ratios. We cannot assure you that

these covenants will not adversely affect our ability to finance our future operations or capital needs or to pursue available business opportunities. A breach of these covenants or our inability to maintain the required financial ratios could result in a default in respect of the related indebtedness. If a default occurs, the relevant lenders could elect to declare the indebtedness, together with accrued interest and other fees, to be immediately due and payable.

Government Regulations; Environmental Conditions. Regulatory requirements could cause us to incur significant liabilities and costs and could restrict our business activities. We are subject to local, state and federal statutes and rules regulating certain developmental matters, as well as building and site design. We are subject to various fees and charges of governmental authorities designed to defray the cost of providing certain governmental services and improvements. We may be subject to additional costs and delays or may be precluded entirely from building projects because of "no-growth" or "slow-growth" initiatives, building permit ordinances, building moratoriums, or similar government regulations that could be imposed in the future due to health, safety, welfare, or environmental concerns. We must also obtain licenses, permits and approvals from government agencies to engage in certain activities, the granting or receipt of which are beyond our control.

We are also subject to a variety of local, state and federal statutes, ordinances, rules and regulations concerning the protection of health and the environment. Environmental laws or permit restrictions may result in project delays, may cause substantial compliance and other costs and may prohibit or severely restrict development in certain environmentally sensitive regions or geographic areas. Environmental regulations can also have an adverse impact on the availability and price of certain raw materials such as lumber.

Recent Acquisitions. During 2002 we acquired Hammonds and Perma-Bilt and we cannot assure you that:

- the Hammonds and Perma-Bilt businesses will be successfully integrated with our existing business;
- the market and financial synergies we anticipate will be achieved in our expected time frame, or at all;
- the acquisitions will be accretive to earnings due to unexpected expenses, contingencies or liabilities, or due to the financial performance of the Hammonds and Perma-Bilt businesses;
- the combined companies will not lose key employees, management, suppliers or subcontractors; and
- we can successfully manage new housing lines that were previously managed by Hammonds and Perma-Bilt or new lines planned for the future.

Future Expansion. We may continue to consider growth or expansion of our operations in our current markets or in other areas of the country. Our expansion into new or existing markets could have a material adverse effect on our cash flows or profitability. The magnitude, timing and nature of any future expansion will depend on a number of factors, including suitable acquisition candidates, the negotiation of acceptable terms, our financial capabilities and general economic and business conditions. New acquisitions may result in the incurrence of additional debt. Acquisitions also involve numerous risks, including difficulties in the assimilation of the acquired company's operations, the incurrence of unanticipated liabilities or expenses, the diversion of management's attention from other business concerns, risks of entering markets in which we have limited or no direct experience and the potential loss of key employees of the acquired company.

Dependence on Key Personnel. Our success largely depends on the continuing services of certain key employees, including Steve Hilton and John Landon, and our continued favorable development depends on our ability to attract and retain qualified personnel. The loss of the services of key employees could harm our business.

Dependence on Subcontractors. We conduct our construction operations only as a general contractor. Virtually all architectural and construction work is performed by unaffiliated third-party subcontractors. As a consequence, we depend on the continued availability of and satisfactory performance by these subcontractors for the design and construction of our homes. We cannot assure you that there will be sufficient availability of and satisfactory performance by these unaffiliated third-party subcontractors. In addition, inadequate subcontractor resources could have a material adverse affect on our business.

Inflation. We, like other homebuilders, may be adversely affected during periods of high inflation, mainly because of higher land and construction costs. Also, higher mortgage interest rates may significantly affect the affordability of mortgage financing to prospective buyers. Inflation also increases our cost of financing, materials and labor and could

cause our financial results or growth to decline. We attempt to pass cost increases on to our customers through higher sales prices. To date, inflation has not had a material adverse effect on our results of operations, although it could impact our future operating results.

Natural Disasters. We have significant homebuilding operations in Texas and Northern California. Some of our markets in Texas occasionally experience severe weather conditions such as tornadoes or hurricanes. Northern California has experienced a significant number of earthquakes, flooding, landslides and other natural disasters in recent years. We do not insure against some of these risks. These occurrences could damage or destroy some of our homes under construction or our building lots, which may result in losses that exceed our insurance coverage. We could also suffer significant construction delays or substantial fluctuations in the pricing or availability of building materials. Any of these events could cause a decrease in our revenue, cash flows and earnings.

Recent Laws, Regulations and Accounting Pronouncements. In the past several months, a number of new laws, governmental and stock exchange regulations, as well as accounting policies, principles or practices, have been adopted or proposed, many of which could, depending on their ultimate outcome or interpretations, affect our corporate governance or accounting methods. As an example, the accounting profession recently adopted new standards for whether certain transactions should be accounted for as on- or off-balance sheet transactions. We have the right to acquire a substantial amount of lot inventory through rolling options with third parties and, to a lesser extent, joint ventures. At the present time, we do not believe that these pronouncements, and other current proposals, will materially affect us; however, we cannot assure you that the ultimate interpretation or implementation of new and proposed laws and other pronouncements will not produce such an effect.

Acts of War. Acts of war or any outbreak or escalation of hostilities between the United States and any foreign power, including the armed conflict with Iraq, may cause disruption to the economy, our company, our employees and our customers, which could impact our revenue, costs and expenses and financial condition.

Special Note of Caution Regarding Forward-Looking Statements

In passing the Private Securities Litigation Reform Act of 1995 (PSLRA), Congress encouraged public companies to make "forward-looking statements" by creating a safe-harbor to protect companies from securities law liability in connection with forward-looking statements. We intend to qualify both our written and oral forward-looking statements for protection under the PSLRA.

The words "believe," "expect," "anticipate," "forecast," "plan," and "project" and similar expressions identify forward-looking statements, which speak only as of the date the statement was made. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1993, and Section 21E of the Exchange Act. Forward-looking statements in this Form 10-K include statements concerning the demand for and the pricing of our homes, our ability to deliver existing backlog, the expected outcome of legal proceedings against us, the sufficiency of our capital resources, the impact of new accounting standards, the future realizability of deferred tax assets, the expectation of continued positive operating results in 2003 and beyond, the expected benefits of the Hammonds and Perma-Bilt acquisitions, including future home closings and Hammonds and Perma-Bilt's future contribution to our revenue and earnings, and our ability to continue positive operating results in light of current economic and political conditions. Such statements are subject to significant risks and uncertainties.

Important factors currently known to management that could cause actual results to differ materially from those in forward-looking statements, and that could negatively affect our business are discussed in this report under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations – Factors That May Affect Our Future Results and Financial Condition."

Forward-looking statements express expectations of future events. All forward-looking statements are inherently uncertain as they are based on various expectations and assumptions concerning future events and they are subject to numerous known and unknown risks and uncertainties that could cause actual events or results to differ materially from those projected. Due to these inherent uncertainties, the investment community is urged not to place undue reliance on forward-looking statements. In addition, we undertake no obligations to update or revise forward-looking statements to

reflect changed assumptions, the occurrence of anticipated events or changes to projections over time. As a result of these and other factors, our stock and note prices may fluctuate dramatically.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

As a result of our senior unsecured notes offering, \$155.0 million of our outstanding borrowings is based on a fixed interest rate. Except in limited circumstances, we do not have an obligation to prepay our fixed-rate debt prior to maturity and, as a result, interest rate risk and changes in fair value should not have a significant impact in the fixed rate debt until we would be required to refinance such debt.

We are exposed to market risk primarily related to potential adverse changes in interest rates on our existing revolving credit facility. The interest rate relative to this borrowing fluctuates with the prime and Eurodollar lending rates, both upwards and downwards. As of December 31, 2002, we had approximately \$107.6 million drawn under our revolving credit facility that is subject to changes in interest rates. An increase or decrease of 1% in interest rates would change our annual debt service payments by approximately \$1.0 million per year.

We do not enter into, or intend to enter into, derivative financial instruments for trading or speculative purposes.

Our operations are interest rate sensitive. Overall housing demand is adversely affected by increases in interest rates. If mortgage interest rates increase significantly, this may negatively affect the ability of homebuyers to secure adequate financing. Higher interest rates could adversely affect our revenues, gross margins and net income and will also increase our borrowing costs because our revolving credit facility will fluctuate with the prime and Eurodollar lending rates, both upwards and downwards.

Item 8. Financial Statements and Supplementary Data

Our consolidated financial statements as of December 31, 2002 and 2001 and for each of the years in the three-year period ended December 31, 2002, together with related notes and the report of KPMG LLP, independent auditors, are on the following pages. Other required financial information is more fully described in Item 16.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Meritage Corporation:

We have audited the accompanying consolidated balance sheets of Meritage Corporation and subsidiaries (the Company) as of December 31, 2002 and 2001, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Meritage Corporation and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company changed their method of accounting for goodwill and other intangible assets in 2002.

KPMG LLP

Phoenix, Arizona
February 6, 2003

MERITAGE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	<u>December 31,</u>	
	<u>2002</u>	<u>2001</u>
	(In thousands, except share data)	
Assets		
Cash and cash equivalents	\$ 6,600	\$ 3,383
Real estate	484,970	330,238
Deposits on real estate under option or contract	77,516	45,252
Receivables	8,894	5,508
Deferred tax asset, net	2,701	2,612
Goodwill	73,785	30,369
Property and equipment, net	14,007	9,667
Prepaid expenses and other assets	<u>23,315</u>	<u>9,686</u>
Total assets	<u>\$ 691,788</u>	<u>\$ 436,715</u>
Liabilities		
Accounts payable	\$ 52,133	\$ 36,168
Accrued liabilities	41,329	32,861
Home sale deposits	16,091	13,538
Notes payable	<u>264,927</u>	<u>177,561</u>
Total liabilities	<u>374,480</u>	<u>260,128</u>
Stockholders' Equity		
Common stock, par value \$0.01. Authorized 50,000,000 shares; issued and outstanding 15,227,460 and 12,613,938 shares at December 31, 2002 and 2001, respectively	152	126
Additional paid-in capital	197,320	109,412
Retained earnings	148,209	78,272
Treasury stock at cost, 2,137,926 and 1,637,926 shares at December 31, 2002 and 2001, respectively	<u>(28,373)</u>	<u>(11,223)</u>
Total stockholders' equity	<u>317,308</u>	<u>176,587</u>
Total liabilities and stockholders' equity	<u>\$ 691,788</u>	<u>\$ 436,715</u>

See accompanying notes to consolidated financial statements

MERITAGE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

	<u>Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(In thousands, except per share data)		
Home sales revenue	\$ 1,112,439	\$ 742,576	\$ 515,428
Land sales revenue	<u>7,378</u>	<u>1,598</u>	<u>5,039</u>
	<u>1,119,817</u>	<u>744,174</u>	<u>520,467</u>
Cost of home sales	(898,343)	(585,440)	(411,203)
Cost of land sales	<u>(6,578)</u>	<u>(1,474)</u>	<u>(4,446)</u>
	<u>(904,921)</u>	<u>(586,914)</u>	<u>(415,649)</u>
Home sales gross profit	214,096	157,136	104,225
Land sales gross profit	<u>800</u>	<u>124</u>	<u>593</u>
	<u>214,896</u>	<u>157,260</u>	<u>104,818</u>
Commissions and other sales costs	(65,291)	(41,085)	(28,680)
General and administrative expenses	(41,496)	(35,723)	(21,215)
Interest expense	—	—	(8)
Other income, net	<u>5,435</u>	<u>2,884</u>	<u>1,847</u>
Earnings before income taxes and extraordinary items	113,544	83,336	56,762
Income taxes	<u>(43,607)</u>	<u>(32,444)</u>	<u>(21,000)</u>
Earnings before extraordinary items	69,937	50,892	35,762
Extraordinary items, net of tax effects	<u>—</u>	<u>(233)</u>	<u>—</u>
Net earnings	<u>\$ 69,937</u>	<u>\$ 50,659</u>	<u>\$ 35,762</u>
Earnings per share:			
Basic:			
Earnings before extraordinary items	\$ 5.64	\$ 4.80	\$ 3.46
Extraordinary items, net of tax effects	<u>—</u>	<u>(0.02)</u>	<u>—</u>
Net earnings per share	<u>\$ 5.64</u>	<u>\$ 4.78</u>	<u>\$ 3.46</u>
Diluted:			
Earnings before extraordinary items	\$ 5.31	\$ 4.32	\$ 3.13
Extraordinary items, net of tax effects	<u>—</u>	<u>(0.02)</u>	<u>—</u>
Net earnings per share	<u>\$ 5.31</u>	<u>\$ 4.30</u>	<u>\$ 3.13</u>

See accompanying notes to consolidated financial statements.

MERITAGE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended December 31, 2002, 2001 and 2000
(In thousands)

	<u>Number of Shares</u>	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings (Accumulated Deficit)</u>	<u>Treasury Stock</u>	<u>Total</u>
Balance at December 31, 1999	10,950	\$ 110	\$ 100,352	\$ (8,149)	\$ (1,902)	\$ 90,411
Net earnings	--	--	--	35,762	--	35,762
Tax benefit from stock option exercises	--	--	1,917	--	--	1,917
Exercise of stock options	718	6	2,044	--	--	2,050
Contingent shares issued	178	2	(2)	--	--	--
Stock option and contingent stock compensation expenses	--	--	73	--	--	73
Purchase of treasury stock	--	--	--	--	(9,114)	(9,114)
Balance at December 31, 2000	11,846	118	104,384	27,613	(11,016)	121,099
Net earnings	--	--	--	50,659	--	50,659
Tax benefit from stock option exercises	--	--	2,486	--	--	2,486
Exercise of stock options	768	8	2,542	--	--	2,550
Purchase of treasury stock	--	--	--	--	(207)	(207)
Balance at December 31, 2001	12,614	126	109,412	78,272	(11,223)	176,587
Net earnings	--	--	--	69,937	--	69,937
Tax benefit from stock option exercises	--	--	5,222	--	--	5,222
Exercise of stock options	601	6	3,006	--	--	3,012
Purchase of treasury stock	--	--	--	--	(17,150)	(17,150)
Issuance of common stock upon public offering	2,012	20	79,680	--	--	79,700
Balance at December 31, 2002	<u>15,227</u>	<u>\$ 152</u>	<u>\$ 197,320</u>	<u>\$ 148,209</u>	<u>\$ (28,373)</u>	<u>\$ 317,308</u>

See accompanying notes to consolidated financial statements

MERITAGE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	<u>Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(In thousands)		
Cash flows from operating activities:			
Net earnings	\$ 69,937	\$ 50,659	\$ 35,762
Adjustments to reconcile net earnings to net cash (used in) provided by operating activities:			
Depreciation and amortization	6,780	5,741	3,407
(Increase) decrease in deferred tax asset before extraordinary items	(89)	(2,069)	156
Stock option and contingent stock compensation expenses	—	—	73
Tax benefit from stock option exercises	5,222	2,486	1,917
Changes in assets and liabilities, net of effect of acquisitions in 2002 and 2001:			
Increase in real estate	(54,896)	(64,386)	(40,295)
Increase in deposits on real estate under option or contract	(29,088)	(12,102)	(8,551)
Increase in receivables and prepaid expenses and other assets	(13,854)	(10,816)	(1,241)
Increase in accounts payable and accrued liabilities	10,291	13,232	12,368
(Decrease) increase in home sale deposits	(139)	118	2,656
Net cash (used in) provided by operating activities	<u>(5,836)</u>	<u>(17,137)</u>	<u>6,252</u>
Cash flows from investing activities:			
Cash paid for acquisitions	(129,582)	(65,759)	(5,158)
Increase in goodwill	(4,938)	(2,710)	—
Purchases of property and equipment	(8,285)	(7,270)	(3,017)
Net cash used in investing activities	<u>(142,805)</u>	<u>(75,739)</u>	<u>(8,175)</u>
Cash flows from financing activities:			
Borrowings	816,153	527,910	447,269
Repayments of debt	(729,857)	(578,391)	(447,054)
Proceeds from issuance of senior notes	—	165,000	—
Repayments of senior notes	—	(25,000)	—
Proceeds from sale of common stock, net	79,700	—	—
Purchase of treasury stock	(17,150)	(207)	(9,114)
Proceeds from exercises of stock options	3,012	2,550	1,797
Net cash provided by (used in) financing activities	<u>151,858</u>	<u>91,862</u>	<u>(7,102)</u>
Net increase (decrease) in cash and cash equivalents	3,217	(1,014)	(9,025)
Cash and cash equivalents, beginning of period	3,383	4,397	13,422
Cash and cash equivalents, end of period	<u>\$ 6,600</u>	<u>\$ 3,383</u>	<u>\$ 4,397</u>

See Supplemental Disclosure of Cash Flow Information at Note 8.

See accompanying notes to consolidated financial statements

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002, 2001 and 2000

NOTE 1 – BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business. We are a leading designer and builder of single-family homes in the rapidly growing Sunbelt states of Texas, Arizona, California and Nevada. We focus on providing a broad range of first-time, move-up and luxury homes to our targeted customer base. We and our predecessors have operated in Arizona since 1985, in Texas since 1987 and in Northern California since 1989. In 2002 we acquired Hammonds Homes (Hammonds), a builder of primarily move-up homes in Houston, Austin and Dallas, Texas, and Perma-Bilt Homes (Perma-Bilt), a homebuilder that serves the first-time and move-up markets in the Las Vegas, Nevada area.

Basis of Presentation. The accompanying consolidated financial statements include our accounts and those of our consolidated subsidiaries. Intercompany balances and transactions have been eliminated in consolidation, and certain prior year amounts have been reclassified to be consistent with current financial statement presentation. Financial results include the operations of Hancock Communities (Hancock) from May 31, 2001, Hammonds from July 1, 2002 and Perma-Bilt from October 1, 2002, the effective dates of the acquisitions (see Note 4).

Critical Accounting Policies and Estimates. We have established various accounting policies which govern the application of accounting principles generally accepted in the United States of America in the preparation and presentation of our consolidated financial statements. Certain accounting policies involve significant judgments, assumptions and estimates by management that have a material impact on the carrying value of certain assets and liabilities, and revenue and costs, which we consider to be critical accounting policies. The judgments, assumptions and estimates we use are based on historical experience, knowledge of the accounts and other factors which we believe to be reasonable under the circumstances and we evaluate our judgments and assumptions on an ongoing basis. Because of the nature of the judgments and assumptions we have made, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of our operations.

The accounting policies that we deem most critical to us, and involve the most difficult, subjective or complex judgments, include our estimates of costs to complete our individual projects, the ultimate recoverability (or impairment) of these costs, goodwill impairment, the likelihood of closing lots held under option or contract and the ability to estimate expenses and accruals, including legal and warranty reserves. Should we under or over estimate costs to complete individual projects, gross margins in a particular period could be misstated and the ultimate recoverability of costs related to a project from home sales may be uncertain. Furthermore, non-refundable deposits paid for land options or contracts may have no economic value to us if we do not ultimately purchase the land. Our inability to accurately estimate expenses, accruals, or an impairment of real estate or goodwill, could result in charges, or income, in future periods, which relate to activities or transactions in a preceding period.

Cash and Cash Equivalents. Liquid investments with an initial maturity of three months or less are classified as cash equivalents. Amounts in transit from title companies for home closings of approximately \$5.2 million and \$317,000 are included in cash and cash equivalents at December 31, 2002 and 2001, respectively.

Real Estate. Real estate consists of finished home sites and home sites under development, completed homes and homes under construction, and land held for development. Costs capitalized include direct construction costs for homes, development period interest and certain common costs that benefit the entire community. Common costs are incurred on a community-by-community basis and allocated to residential lots based on the number of lots to be built in the project, which approximates the relative sales value method.

An impairment loss is recorded when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable from the cash flows generated by future disposition. In such cases, amounts are carried at the lower of cost or estimated fair value less disposal costs.

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Deposits paid related to land options and contracts to purchase land are capitalized when incurred and classified as deposits on real estate under option or contract until the related land is purchased. The deposits are then transferred to real estate at the time the lots are acquired. Deposits are charged to expense if the land acquisition is no longer considered probable.

Cost of Home Sales. Cost of home sales includes direct home construction costs, closing costs, land acquisition and development costs, development period interest, and common costs. Direct construction costs are accumulated during the period of construction and charged to cost of sales under specific identification methods, as are closing costs. Land acquisition and development costs, interest and common costs are allocated based on the number of homes to be built in each community, which approximates the relative sales value method.

Estimated future warranty costs are charged to cost of sales in the period when the revenues from the related home closings are recognized. Costs are accrued based upon historical experience and generally range from 0.45% to 0.75% of the home's sales price. (See Note 11.)

Revenue Recognition. Revenues from sales of residential real estate and related activities are recognized when closings have occurred, the buyer has made the required minimum down payment and other criteria for sale and profit recognition are satisfied.

Property and Equipment. Property and equipment consists of approximately \$3.3 million of computer and office equipment and approximately \$10.7 million of model home furnishings, and is stated at cost less accumulated depreciation. Accumulated depreciation related to these assets amounted to approximately \$10.5 million and \$7.1 million at December 31, 2002 and 2001, respectively. Depreciation is generally calculated using the straight-line method over the estimated useful lives of the assets, which range from three to seven years. Maintenance and repair costs are expensed as incurred.

Deferred Costs. We incurred costs of approximately \$5.2 million related to the 2001 issuance of our 9.75% senior notes, due June 2011 and approximately \$1.5 million in bank fees related to the addition of our December 2002 credit facility. We have deferred these costs and are amortizing them using the effective interest method over the life of the debt. At December 31, 2002 and 2001, approximately \$5.9 million and \$4.9 million, respectively, of deferred costs, net of amortization, were included on our balance sheets within prepaid expenses and other assets.

Income Taxes. We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in future years and are subsequently adjusted for changes in the rates. The effect on deferred tax assets and liabilities of a change in tax rates is a charge or credit to deferred tax expense in the period of enactment.

Stock Split. On April 2, 2002, our Board of Directors declared a two-for-one split of our common stock in the form of a stock dividend to stockholders of record on April 12, 2002. The additional shares were distributed on April 26, 2002. All share and per share amounts have been restated to reflect the split.

Earnings Per Share. We compute basic earnings per share by dividing earnings available to common stockholders by the weighted-average number of common shares outstanding during the year. Diluted earnings per share reflects the potential dilution that could occur if dilutive securities or contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in our earnings.

Stock-Based Compensation. See discussion of SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," under this note, "Impact of Recently Issued Accounting Standards".

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

At December 31, 2002, we had one stock-based employee compensation plan, which is described more fully in Note 6. We apply the intrinsic value-based method of accounting prescribed in Accounting Principles Board ("APB") Opinion No. 25 "Accounting for Stock Issued to Employees", as allowed by SFAS No. 123 "Accounting for Stock-Based Compensation." Under this method, compensation expense is recorded on the date of the grant only if the market price of the underlying stock on the date of the grant was greater than the exercise price. SFAS No. 123 established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, we have elected to continue to apply the intrinsic value-based method of accounting described above, and have adopted the disclosure requirements of SFAS No. 123. As we do not issue options with exercise prices below the market value on the date of the grant, we do not recognize compensation expense for our stock-based plan. Had compensation cost for these plans been determined pursuant to SFAS No. 123, our net earnings and earnings per share would have been reduced to the following pro forma amounts.

		Years Ended December 31,		
		(in thousands, except per share amounts)		
		2002	2001	2000
Net earnings	As reported	\$ 69,937	\$ 50,659	\$ 35,762
	Deduct*	(2,237)	(1,464)	(298)
	Pro forma	\$ 67,700	\$ 49,195	\$ 35,464
Basic earnings per share	As reported	\$ 5.64	\$ 4.78	\$ 3.46
	Pro forma	\$ 5.46	\$ 4.64	\$ 3.43
Diluted earnings per share	As reported	\$ 5.31	\$ 4.30	\$ 3.13
	Pro forma	\$ 5.14	\$ 4.18	\$ 3.10

*Deduct: Total stock-based employee compensation expense determined under fair value based method for awards, net of related tax effects. See Note 6 for assumptions used to determine fair value.

To date, we have only granted options to employees and non-employee directors.

Goodwill. Effective January 1, 2002, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets." Upon the adoption of SFAS No. 142, goodwill is no longer subject to amortization. Goodwill is subject to at least an annual assessment for impairment by applying a fair value-based test. If the carrying amount of the net assets of an identified reporting unit exceeds the fair value of that reporting unit, goodwill is considered to be impaired. We continually evaluate whether events and circumstances have occurred that indicate the remaining balance of goodwill may not be recoverable. In evaluating impairment, we base our estimates of fair value on an analysis of selected business acquisitions in the homebuilding industry provided to us by an independent third party. Such evaluations for impairment are significantly impacted by the amount a buyer is willing to pay in the current market for a like business. If the goodwill is considered to be impaired, the impairment loss to be recognized is measured by the amount by which the carrying amount of the goodwill exceeds the fair value of the net assets identified in our reporting units. See "Impact of Recently Issued Accounting Standards" for further information on goodwill.

Fair Value of Financial Instruments. We determine fair value of financial instruments as required by SFAS No. 107, "Disclosures about Fair Value of Financial Instruments."

The estimated fair value of our 9.75% senior notes at December 31, 2002 and 2001 was \$162.0 million and \$160.4 million, respectively, based on independent dealer quotes. The recorded amount of our senior notes at December 31, 2002 and 2001 was \$155.0 million.

Our revolving credit facility and acquisition and development loans carry interest rates that are variable and/or comparable to current market rates based on the nature of the obligations, their terms and remaining maturity, and therefore, the cost basis approximates fair value.

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Due to the short term nature of other financial assets and liabilities, we consider the carrying amounts of our short-term financial instruments to be at fair value.

Impact of Recently Issued Accounting Standards. In January 2003, the FASB issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities". This interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", addresses consolidation by business enterprises of variable interest entities (selected entities with related contractual, ownership, voting or other monetary interests, including certain special purpose entities), and requires certain additional disclosure with respect to these entities. The provisions of FIN 46 are applicable immediately to variable interest entities created after January 31, 2003. A public entity with a variable interest in a variable interest entity created before February 1, 2003, shall apply the provisions of FIN 46 to that entity no later than the beginning of the first interim or annual reporting period beginning after June 15, 2003. We do not expect the requirements of FIN 46 to have a material impact on our consolidated financial statements.

In December 2002, the FASB issued SFAS 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." This amendment to FASB Statement No. 123 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of FASB Statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The provisions of this statement are effective for financial statements of interim or annual periods after December 15, 2002. We do not intend to change to the fair value method of accounting. The required disclosures are included in the stock-based compensation section of this note.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This interpretation expands the disclosures to be made by a guarantor in its financial statements about its obligations under certain guarantees and requires the guarantor to recognize a liability for the fair value of an obligation assumed under a guarantee. FIN 45 clarifies the requirements of SFAS No. 5, "Accounting for Contingencies," relating to guarantees. In general, FIN 45 applies to contracts or indemnification agreements that contingently require the guarantor to make payments to the guaranteed party based on changes that are related to an asset, liability, or equity security of the guaranteed party. Certain guarantee contracts are excluded from both the disclosure and recognition requirements of this interpretation, including, among others, guarantees relating to employee compensation, residual value guarantees under capital lease arrangements, commercial letters of credit, loan commitments, subordinated interests in a special purpose entity, and guarantees of a company's own performance. Other guarantees are subject to the disclosure requirements of FIN 45 but not to the recognition provisions and include, among others, a guarantee accounted for as a derivative instrument under SFAS 133, a parent's guarantee of debt owed to a third party by its subsidiary or vice versa, and a guarantee which is based on performance, not price. The disclosure requirements of FIN 45 are effective for the Company as of December 31, 2002 and require disclosure of the nature of the guarantee, the maximum potential amount of future payments that the guarantor could be required to make under the guarantee, and the current amount of the liability, if any, for the guarantor's obligations under the guarantee. The recognition requirements of FIN 45 are to be applied prospectively to guarantees issued or modified after December 31, 2002. We do not expect the requirements of FIN 45 to have a material impact on our consolidated financial statements. For disclosures required by FIN 45 applicable to us, see Note 11, "Commitments and Contingencies".

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets," that supersedes APB Opinion No. 17. Under SFAS 142, goodwill and intangible assets deemed to have indefinite lives are no longer amortized, but are to be reviewed at least annually for impairment, under impairment guidelines established in the statement. SFAS 142 also changes the amortization methodology in intangible assets that are deemed to have finite lives and adds to required disclosures regarding goodwill and intangible assets. SFAS 142 is effective for fiscal years beginning after December 15, 2001. We adopted SFAS 142 on January 1, 2002 and our unamortized balance of goodwill as of that date was approximately \$30.4 million. Beginning in 2002, we ceased our amortization of goodwill. Goodwill amortization for 2001 and 2000 was approximately \$1.4 million and \$1.1 million, respectively. If SFAS No. 142 had been in effect in 2001 and 2000, net earnings for the years ended December 31, 2001 and 2000 would have been

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

\$51.5 million and \$36.4 million, respectively, and diluted earnings per share would have been \$4.38 and \$3.19, respectively.

During 2002, under guidelines contained in the statement, management performed an analysis concerning potential impairment of the goodwill carried and determined that no impairment existed. A subsequent assessment is being performed in the first quarter of 2003, and to date, no impairment has been found to exist. See Note 4, "Acquisitions".

NOTE 2 - REAL ESTATE AND CAPITALIZED INTEREST

The components of real estate at December 31 are as follows (in thousands):

	<u>2002</u>	<u>2001</u>
Homes under contract, in production	\$ 191,761	\$ 135,005
Finished home sites	123,500	81,151
Home sites under development	66,552	57,291
Homes held for resale	55,273	33,278
Model homes	19,160	18,289
Land held for development	<u>28,724</u>	<u>5,224</u>
	<u>\$ 484,970</u>	<u>\$ 330,238</u>

We capitalize certain interest costs incurred during development and construction. Capitalized interest is allocated to real estate under development and charged to cost of sales when the related property is closed. Summaries of interest incurred, interest capitalized and interest expensed follow (in thousands):

	<u>Years Ended December 31,</u>	
	<u>2002</u>	<u>2001</u>
Interest capitalized, beginning of year	\$ 8,746	\$ 5,426
Interest capitalized	19,294	16,623
Amortization to cost of home and land sales	<u>(19,259)</u>	<u>(13,303)</u>
Interest capitalized, end of year	<u>\$ 8,781</u>	<u>\$ 8,746</u>
Interest incurred	\$ 19,294	\$ 16,623
Interest capitalized	<u>(19,294)</u>	<u>(16,623)</u>
Interest expensed	<u>\$ --</u>	<u>\$ --</u>

The purchase of real estate under option contracts with specific performance is dependent upon the completion of certain requirements by the sellers and us. At December 31, 2002, we had approximately 611 home sites with an aggregate purchase price of approximately \$34.8 million under option contracts with specific performance. Real estate under option or contract and related deposits are summarized below (dollars in thousands):

	<u>Number of</u>	<u>Deposits on Real</u>	<u>Letters of Credit</u>
	<u>Home Sites</u>	<u>Estate Under</u>	<u>on Real Estate</u>
		<u>Option or</u>	<u>Under Option or</u>
		<u>Contract</u>	<u>Contract</u>
Real estate under option or contract with specific performance	611	\$ 6,010	\$ 2,017
Real estate under option or contract with non-specific performance	<u>19,950</u>	<u>71,506</u>	<u>13,118</u>
	<u>20,561</u>	<u>\$ 77,516</u>	<u>\$ 15,135</u>

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 – NOTES PAYABLE

Notes payable at December 31 consist of the following:

	<u>2002</u>	<u>2001</u>
	<u>(in thousands)</u>	
\$250 million unsecured revolving credit facility maturing December 12, 2005 with extension provisions, with interest payable monthly approximating prime (4.25% at December 31, 2002) or LIBOR (approximately 1.383% at December 31, 2002) plus 2.0%.	\$ 107,565	—
\$100 million bank revolving construction line of credit. Paid in full during 2002.	—	\$ 617
\$90 million bank revolving construction line of credit. Paid in full during 2002.	—	15,590
Acquisition and development seller carry back financing, interest payable monthly at rates ranging from prime to prime plus 0.25% or at a fixed rate of 10% per annum; payable at the earlier of funding of construction financing or the maturity date of the individual projects, secured by first deeds of trust on real estate	2,362	6,204
Senior unsecured notes, maturing June 1, 2011, interest only payments at 9.75% per annum, payable semi-annually	155,000	155,000
Other	—	150
Total	<u>\$ 264,927</u>	<u>\$ 177,561</u>

In May 2001, we issued \$165 million in principal amount of 9.75% senior notes due June 1, 2011. Approximately \$15.9 million of this amount was used to repay existing senior notes. The early repayment of debt resulted in prepayment fees of approximately \$731,000, which, net of the related income tax benefit of approximately \$286,000, resulted in an extraordinary loss of \$445,000.

In September 2001, we purchased and retired \$10 million in principal amount of our outstanding 9.75% senior notes for 93.25% of par. The purchases resulted in an extraordinary gain of \$212,000 (net of approximately \$136,000 in income taxes).

In February 2003 we completed an add-on offering of \$50 million in aggregate principal amount of our 9.75% senior notes due June 1, 2001. The notes were issued at a price of 103.25% of their face amount to yield 9.054%, and together with the May 2001 offering, constitute a single series of notes.

Scheduled maturities of notes payable as of December 31, 2002 follow (in thousands):

Years Ended <u>December 31,</u>	
2003	\$ 1,808
2004	554
2005	107,565
2006	—
2007	—
Thereafter	<u>155,000</u>
	<u>\$ 264,927</u>

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Obligations to pay principal and interest on our bank credit facility and senior unsecured notes are guaranteed by all of our wholly-owned subsidiaries (Guarantor Subsidiaries), other than certain minor subsidiaries (collectively, Non-Guarantor Subsidiaries). Such guarantees are full and unconditional, and joint and several. Separate financial statements of the Guarantor Subsidiaries are not provided because Meritage Corporation (the parent company) has no independent assets or operations and the Non-Guarantor Subsidiaries are, individually and in the aggregate, minor. There are no significant restrictions on the ability of the parent company or any guarantor to obtain funds from its subsidiaries by dividend or loan.

The bank credit facility and senior unsecured notes contain covenants which require maintenance of certain levels of tangible net worth, compliance with certain minimum financial ratios and place limitations on the payment of dividends and limit incurrence of indebtedness, asset dispositions and creations of liens, among other items. As of December 31, 2002 and 2001 and for the years then ended we were in compliance with these covenants.

NOTE 4 - ACQUISITIONS

Perma-Bilt Acquisition. Effective October 1, 2002, we purchased the homebuilding assets of Perma-Bilt Homes ("Perma-Bilt Homes" or "Perma-Bilt"), a builder of single-family homes in the Las Vegas, Nevada metropolitan area. The purchase price was approximately \$46.6 million in cash including the repayment of existing debt in the amount of \$16.7 million. We also assumed accounts payable, accrued liabilities and home sale deposits totaling \$5.8 million. In addition, we agreed to an earn-out of 10% of the pre-tax profits of Perma-Bilt, payable in cash over three years. Perma-Bilt Homes builds a wide range of homes with a focus on serving the move-up housing markets in Nevada.

Hammonds Acquisition. On July 1, 2002, we acquired substantially all of the homebuilding and related assets of Hammonds Homes, Ltd., and Crystal City Land & Cattle, Ltd., (collectively, "Hammonds Homes" or "Hammonds"). The purchase price was approximately \$83.4 million in cash plus the assumption of accounts payable, accrued liabilities, and home sale deposits totaling \$11.0 million and a note payable totaling \$1.1 million. Established in 1987, Hammonds Homes builds a wide range of homes in communities throughout the Houston, Dallas/Ft. Worth and Austin, Texas areas with a focus on serving the move-up housing market.

Hancock Acquisition. On May 30, 2001, we acquired substantially all of the homebuilding and related assets of HC Builders, Inc. and Hancock Communities, L.L.C. (collectively, "Hancock Communities" or "Hancock"). The purchase price was \$65.8 million in cash, plus the assumption of accounts payable, accrued liabilities and home sales deposits totaling \$9.4 million and a note payable totaling \$1.9 million. In addition, we granted the founder of Hancock, an earn-out, payable in cash over three years, equal to 20% of Hancock's pre-tax net income after a 10.5% charge on capital. Hancock serves the first-time and move-up markets throughout the Phoenix area.

The following unaudited pro forma financial data for the years ended December 31, 2002, 2001, and 2000 has been prepared as if the acquisition of the assets and liabilities of Hancock on May 30, 2001 had occurred on January 1, 2000, and as if the acquisitions of Hammonds on July 1, 2002 and Perma-Bilt on October 1, 2002 had occurred on January 1, 2001. Unaudited pro forma financial data is presented for informational purposes only and is based on historical information. This information may not be indicative of our actual amounts had the transactions occurred on the dates listed above, nor does it purport to represent future periods (in thousands except per share amounts):

	<u>Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Revenue	\$ 1,269,703	\$ 1,063,733	\$ 704,118
Earnings before extraordinary items	75,568	69,357	43,422
Net earnings	75,568	69,569	42,976
Diluted EPS before extraordinary items	6.09	5.89	3.80
Diluted EPS after extraordinary items	5.74	5.91	3.76

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Goodwill. Goodwill represents the excess of the purchase price of our acquisitions over the fair value of the assets acquired. The acquisitions of Hammonds, Perma-Bilt and Hancock were recorded using the purchase method of accounting with the results of operations of these entities included in our consolidated financial statements as of the date of the acquisition. The purchase prices were allocated based on estimated fair value of the assets and liabilities at the date of the acquisition. Intangible assets equal to the excess purchase price over the fair value of the net assets of \$21.3 million, \$17.2 million and \$11.4 million for Hammonds, Perma-Bilt and Hancock, respectively, were recorded as goodwill, which is presented on the consolidated balance sheet. The Hancock goodwill was being amortized on a straight line basis over a period of twenty years during fiscal 2001.

The changes in the carrying amount of goodwill related to our reportable segments for the year ended December 31, 2002 are as follows (in thousands):

	<u>Texas</u>	<u>Arizona</u>	<u>California</u>	<u>Nevada</u>	<u>Total</u>
Balance, beginning of year	\$ 13,457	\$ 15,084	\$ 1,828	—	\$ 30,369
Goodwill acquired during the year	\$ 21,250	—	—	\$ 17,228	\$ 38,478
Increase in goodwill due to earnout agreements	—	\$ 4,571	—	367	4,938
Balance, end of year	<u>\$ 34,707</u>	<u>\$ 19,655</u>	<u>\$ 1,828</u>	<u>\$ 17,595</u>	<u>\$ 73,785</u>

NOTE 5 – EARNINGS PER SHARE

A summary of the reconciliation from basic earnings per share to diluted earnings per share for the years ended December 31, follows (in thousands, except per share amounts):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Earnings before extraordinary items*	\$ 69,937	\$ 50,892	\$ 35,762
Extraordinary items, net of tax effects	—	(233)	—
Net earnings	<u>\$ 69,937</u>	<u>\$ 50,659</u>	<u>\$ 35,762</u>
Weighted average number of shares outstanding	<u>12,405</u>	<u>10,610</u>	<u>10,342</u>
Basic:			
Basic earnings per share before extraordinary items	\$ 5.64	\$ 4.80	\$ 3.46
Extraordinary items	—	(0.02)	—
Basic earnings per share	<u>\$ 5.64</u>	<u>\$ 4.78</u>	<u>\$ 3.46</u>
Diluted:			
Weighted average number of shares outstanding	12,405	10,610	10,342
Effect of dilutive securities:			
Contingent shares and warrants	—	—	38
Options to acquire common stock	766	1,166	1,048
Diluted weighted common shares outstanding	<u>13,171</u>	<u>11,776</u>	<u>11,428</u>
Diluted earnings per share before extraordinary items	\$ 5.31	\$ 4.32	\$ 3.13
Extraordinary items	—	(0.02)	—
Diluted earnings per share	<u>\$ 5.31</u>	<u>\$ 4.30</u>	<u>\$ 3.13</u>
Antidilutive stock options not included in the calculation of diluted earnings per share	<u>307</u>	<u>—</u>	<u>76</u>

* There were no reconciling items between earnings before extraordinary items on a basic or diluted basis.

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 – STOCK-BASED COMPENSATION

Our Board of Directors administers our current stock option plan which has been approved by our stockholders. The plan authorizes grants of incentive stock options and non-qualified stock options to our executives, directors, employees and consultants and provides a means of performance-based compensation in order to attract and retain qualified employees. At December 31, 2002, a total of 1,656,150 shares of Meritage common stock were reserved for issuance upon exercise of stock options granted under this plan. The options vest over periods from two to five years from the date such options were granted, are based on continued employment or service and expire five to ten years after the date of grant.

We apply APB Opinion No. 25 and related interpretations in accounting for our plan. Under APB No. 25, if the exercise price of our stock options is at least equal to the market price of the underlying stock on the date of the grant, no compensation expense is recognized. Pro forma information regarding net earnings and net earnings per share is required by SFAS No. 148 and is included in Note 1.

The fair value for these options was established at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for the years presented:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Expected dividend yield	0%	0%	0%
Risk-free interest rate	4.57%	4.79%	6.71%
Expected volatility	55%	55%	47%
Expected life (in years)	7	6	6
Weighted average fair value of options	\$23.48	\$16.64	\$5.67

Other Options

In connection with our merger and combination with Legacy Homes, Messrs. Hilton and Landon each received 333,334 (adjusted for our 2-for-1 stock split) non-qualified stock options with three year vesting periods. The exercise price of these options was \$2.625 (adjusted for our 2-for-1 stock split) per share, which was negotiated at the time of the transactions. All of these options were exercised by December 31, 2002.

Summary of stock option activity:

	<u>Years Ended December 31,</u>					
	<u>2002</u>	<u>2001</u>		<u>2000</u>		
	<u>Options</u>	<u>Weighted Average Exercise Price</u>	<u>Options</u>	<u>Weighted Average Exercise Price</u>	<u>Options</u>	<u>Weighted Average Exercise Price</u>
Options outstanding at beginning of year	1,620,726	\$ 18.12	1,788,000	\$ 4.37	2,346,452	\$ 3.83
Granted	320,000	38.76	643,900	15.17	179,600	5.22
Exercised	(600,956)	4.83	(768,294)	3.32	(718,052)	2.50
Canceled	(21,420)	17.25	(42,880)	7.88	(20,000)	6.09
Options outstanding at end of year	<u>1,318,350</u>	\$ 17.98	<u>1,620,726</u>	\$ 9.06	<u>1,788,000</u>	\$ 4.37
Options exercisable at end of year	285,690		588,588		1,175,400	
Price range of options exercised	\$2.81 - \$14.43		\$2.625 - \$8.815		\$2.185 - \$7.125	
Price range of options outstanding	\$2.81 - \$45.80		\$2.625 - \$20.885		\$2.625 - \$9.00	
Total shares reserved at end of year	1,656,150		1,657,108		2,453,142	

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Stock options outstanding at December 31, 2002, were:

<u>Range of Exercise Prices</u>	<u>Stock Options Outstanding</u>			<u>Stock Options Exercisable</u>	
	<u>Number</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number</u>	<u>Weighted Average Exercise Price</u>
\$ 2.81 - \$ 9.00	445,830	3.2 years	\$ 6.53	198,910	\$ 6.34
\$ 14.00 - \$ 21.00	555,020	4.4 years	15.29	86,780	15.83
\$ 31.00 - \$ 45.80	317,500	6.6 years	38.76	-	-
	<u>1,318,350</u>	4.8 years	\$ 17.98	<u>285,690</u>	\$ 9.22

NOTE 7 – INCOME TAXES

Total income tax expense (benefit) was allocated as follows (in thousands):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Income from continuing operations	\$ 43,607	\$ 32,444	\$ 21,000
Extraordinary items	-	(149)	-
	<u>\$ 43,607</u>	<u>\$ 32,295</u>	<u>\$ 21,000</u>

Components of income tax expense attributable to income from continuing operations are (in thousands):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Current taxes:			
Federal	\$ 37,839	\$ 29,295	\$ 18,255
State	5,857	5,218	2,589
	<u>43,696</u>	<u>34,513</u>	<u>20,844</u>
Deferred taxes:			
Federal	(75)	(1,742)	140
State	(14)	(327)	16
	<u>(89)</u>	<u>(2,069)</u>	<u>156</u>
Total	<u>\$ 43,607</u>	<u>\$ 32,444</u>	<u>\$ 21,000</u>

Income taxes differ for the years ended December 31, 2002, 2001 and 2000, from the amounts computed using the expected federal statutory income tax rate of 35% as a result of the following (in thousands):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Expected taxes at current federal statutory income tax rate	\$ 39,740	\$ 29,355	\$ 19,299
State income taxes	3,815	3,097	1,719
Non-deductible merger/acquisition costs and other	52	(8)	(18)
income tax expense	<u>\$ 43,607</u>	<u>\$ 32,444</u>	<u>\$ 21,000</u>

The actual tax provision differs from the expected tax expense computed by applying the applicable United States federal corporate tax rate of 35% and the composite state tax rates, which range from 0.0% to 6.4% to the income before taxes for the years ended December 31, 2002, 2001 and 2000. This is principally due to merger/acquisition costs and other various income and expense items that are not deductible for tax purposes, including certain meal and entertainment deductions.

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Deferred tax assets and liabilities have been recognized in the consolidated balance sheets due to the following temporary differences at December 31, 2002 and 2001 (in thousands):

	<u>2002</u>	<u>2001</u>
Deferred tax assets:		
Warranty reserve	\$ 1,854	\$ 931
Real estate and fixed asset basis differences	2,296	450
Wages payable	690	1,719
Other	<u>761</u>	<u>400</u>
Total deferred tax assets	5,601	3,500
Deferred tax liabilities:		
Deductible merger/acquisition costs	<u>(2,900)</u>	<u>(888)</u>
Net deferred tax asset	<u>\$ 2,701</u>	<u>\$ 2,612</u>

We believe it is more likely than not that future operating results will generate sufficient taxable income to realize the net deferred tax asset.

NOTE 8 – SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Additional information related to our Consolidated Statements of Cash Flows follows (in thousands):

The 2002 acquisitions of Hammonds and Perma-Bilt and the 2001 acquisition of Hancock resulted in the following changes in assets and liabilities:

	<u>2002</u>	<u>2001</u>
Increase in real estate	\$ (99,836)	\$ (54,545)
Increase in deposits on real estate under option or contract	(3,176)	(8,899)
Increase in receivables and other assets	(3,514)	(543)
Increase in goodwill	(38,479)	(11,423)
Increase in property and equipment	(2,481)	(1,632)
Increase in accounts payable and accrued liabilities	14,142	6,890
Increase in home sale deposits	2,692	2,503
Increase in notes payable	<u>1,070</u>	<u>1,890</u>
Net cash paid for acquisition	<u>\$ (129,582)</u>	<u>\$ (65,759)</u>

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Cash paid during the year for:			
Interest	\$ 18,613	\$ 14,722	\$ 8,403
Income taxes	\$ 35,404	\$ 31,160	\$ 18,786

NOTE 9 – RELATED PARTY TRANSACTIONS

We have transacted business with related or affiliated companies and with certain officers and directors of the Company. We believe that the terms and fees negotiated for all transactions listed below are no less favorable than those that could be negotiated in arm's length transactions.

Since 1997, we have leased office space in Plano, Texas from Home Financial Services, a Texas partnership owned by John Landon, our co-chief executive officer, and his wife. The lease expires in May 2005. Rents paid to the partnership were \$225,182, \$193,771, and \$185,613, in 2002, 2001 and 2000, respectively, and were recorded as general and administrative expenses on our consolidated statement of earnings.

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

During 2002, we chartered an aircraft from a company in which Steve Hilton, our co-chief executive officer, has an ownership interest. The total amount paid for the charter service in 2002 was approximately \$128,000, which was included within general and administrative expenses on our consolidated statements of earnings.

We paid legal fees of approximately \$432,000, \$420,000 and \$311,000 to law firms of which C. Timothy White, one of our directors, is a partner, in 2002, 2001 and 2000, respectively. These fees were recorded as general and administrative expenses on our consolidated statements of earnings.

One of our directors, Ray Oppel, has invested in various limited partnerships that enter into landbanking transactions with us. Mr. Oppel's limited partnership ownership percentage in these entities ranges from 21.5% to 34.2%. Mr. Oppel also has a 7.5% limited partnership interest in a joint venture that sells lots to Hammonds Homes, which was made prior to our acquisition of Hammonds. By the end of 2001, Mr. Oppel had discontinued making new investments in landbanking transactions that involved sales to Meritage.

In connection with our 2001 acquisition we assumed various existing transactions between Greg Hancock and Hancock Communities. Greg Hancock was the founder of Hancock Communities and from June 2002 until February 2003 was a division president of Meritage. The following agreements are still in place:

Mr. Hancock is the majority owner of a venture that is developing a master planned community in Buckeye, Arizona. We have entered into an option contract to purchase approximately 586 acres of residential land in this community. At December 31, 2002, we had paid option deposits to the venture totaling \$750,000, which is included in deposits on real estate under option or contract on our accompanying balance sheet. In 2002 we purchased approximately 200 acres of this residential land from the venture at a cost of approximately \$5.2 million. We did not purchase land from this entity in 2001. We also perform certain planning and construction supervision functions for the venture for which we are paid a management fee of 3% of the development costs. We earned approximately \$808,700 and \$173,000 in 2002 and 2001, respectively, pursuant to this arrangement, which we recorded as other income in our statement of earnings.

At December 31, 2001, we owed approximately \$1.9 million to a venture controlled by Mr. Hancock that had sold land to Hancock. The note payable was repaid in full in January 2002.

At December 31, 2001, Mr. Hancock owed us approximately \$340,000, related to the resolution of various post-closing matters pertaining to the Hancock acquisition. This obligation was recorded as a receivable on our balance sheet and was paid in full in January 2002.

In 2002 we purchased land from an independent third party to whom Mr. Hancock had loaned money for the purpose of making the underlying debt service payments on a parcel of land. In connection with our acquisition of this parcel, we assumed the seller's obligation to repay the loan to Mr. Hancock, and at December 31, 2002, we had a note payable to him for \$850,000. This note relates to a development in Arizona and will be repaid to Mr. Hancock as the homes in that community close. The note is carried on our consolidated balance sheet within notes payable.

NOTE 10 - SEGMENT INFORMATION

During 2002 we changed the composition of our reportable segments. We classify our operations into four primary operating segments: Texas, Arizona, California and Nevada. These segments generate revenue through home sales to external customers and are not dependent on any one major customer. In 2001, we classified our operations into two segments, first-time and volume priced homes, and mid to luxury priced homes. This previous classification structure was based on placing our various divisions into the two categories based on the primary price range of homes built by that division. We changed our classification structure because as our divisions broadened the price ranges of homes they build, it became impractical to place a division in one or the other category. Accordingly, the current structure summarizes our divisions by the states in which they are located. We have restated the corresponding items of segment information for earlier periods presented.

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Operational information relating to our business segments follows. Information has been included for Hammonds from July 1, 2002 and for Perma-Bilt from October 1, 2002, the effective acquisition dates. Certain information has not been included by segment due to the immateriality of the amount to the segment or in total. We evaluate segment performance based on several factors, of which the primary financial measure is earnings before interest, taxes and extraordinary items (EBIT). The accounting policies of the business segments are the same as those described in Note 1. There are no significant transactions between our primary segments.

	<u>Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
		(in thousands)	
<u>Home Sales Revenue:</u>			
Texas	\$ 387,264	\$ 259,725	\$ 214,472
Arizona	445,275	325,918	175,674
California	245,640	156,933	125,282
Nevada	34,260	—	—
Total	<u>\$ 1,112,439</u>	<u>\$ 742,576</u>	<u>\$ 515,428</u>

	<u>Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
		(in thousands)	
<u>EBIT:</u>			
Texas	\$ 42,918	\$ 43,420	\$ 35,082
Arizona	57,685	35,432	17,666
California	36,418	23,604	16,819
Nevada	2,056	—	—
Corporate and other	(6,274)	(5,816)	(3,626)
Total	<u>\$ 132,803</u>	<u>\$ 96,640</u>	<u>\$ 65,941</u>

	<u>December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
		(in thousands)	
<u>Assets at Year End:</u>			
Texas	\$ 274,163	\$ 139,288	\$ 108,238
Arizona	230,176	198,637	102,746
California	113,467	88,056	53,723
Nevada	62,143	—	—
Corporate and other	11,839	10,734	2,368
Total	<u>\$ 691,788</u>	<u>\$ 436,715</u>	<u>\$ 267,075</u>

NOTE 11- COMMITMENTS AND CONTINGENCIES

We are involved in various routine legal proceedings incidental to our business, some of which are covered by insurance. With respect to all pending litigation matters, our ultimate legal and financial responsibility, if any, cannot be estimated with certainty and, in most cases, potential losses related to those matters are not considered probable. We have accrued approximately \$937,000 for losses related to potential litigation where our ultimate exposure is considered probable and the potential loss can be reasonably estimated, which is classified within accrued liabilities on our December 31, 2002 balance sheet. We believe that none of these matters will have a material adverse impact upon our consolidated financial condition, results of operations or cash flows.

In the normal course of business, we provide standby letters of credit and performance bonds issued to third parties to secure performance under various contracts. At December 31, 2002, we had outstanding letters of

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

credit of \$16.2 million and performance bonds of \$72.9 million. We do not believe that these letters of credit or bonds will be drawn upon.

As a part of our model home construction activities, we enter into lease transactions with third parties. The total cost, including land, and construction of model homes leased by us under these lease agreements is approximately \$38.6 million, all of which is excluded from our balance sheet as of December 31, 2002.

We lease office facilities, model homes and equipment under various operating lease agreements. Approximate minimum lease payments for non-cancelable operating leases as of December 31, 2002, are as follows (in thousands):

Years Ended December 31,	
2003	\$ 3,645
2004	1,973
2005	1,248
2006	242
2007	19
Thereafter.....	-
	<u>\$ 7,127</u>

Rent expense approximated \$3.4 million, \$2.5 million and \$1.6 million in 2002, 2001 and 2000, respectively, and is recorded as general and administrative expense.

We have certain obligations related to post-construction warranties and defects related to homes sold. Historically, these amounts have not been material and we do not anticipate future obligations to be material. At December 31, 2002, we had approximately \$6.7 million in reserves for various warranty claims. Summaries of our warranty reserve follow:

	Years Ended December 31,	
	2002	2001
Warranty reserve, beginning of year	\$ 4,071	\$ 2,320
Additions to reserve	7,041	4,771
Warranty claims and expenses	<u>(4,436)</u>	<u>(3,020)</u>
Warranty reserve, end of year	<u>\$ 6,676</u>	<u>\$ 4,071</u>

Warranty reserves are included in accrued liabilities within the accompanying consolidated balance sheets. Additions to warranty reserves are included in cost of sales within the accompanying statements of earnings.

NOTE 12 - SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly results for the years ended December 31, 2002 and 2001 follow (in thousands, except per share amounts):

	First	Second	Third	Fourth
2002				
Revenue	\$ 169,731	\$ 251,441	\$ 329,129	\$ 369,516
Gross profit	31,636	50,092	64,406	68,762
Earnings before income taxes	14,043	24,806	36,746	37,949
Net earnings	8,566	14,938	22,437	23,996
Per Share Data:				
Basic earnings per share	\$ 0.77	\$ 1.28	\$ 1.66	\$ 1.80
Diluted earnings per share	\$ 0.72	\$ 1.19	\$ 1.58	\$ 1.72
2001				
Revenue	\$ 116,706	\$ 175,408	\$ 207,177	\$ 244,883

MERITAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
2001				
Revenue	\$ 116,706	\$ 175,408	\$ 207,177	\$ 244,883
Extraordinary items, net of tax effects		(445)	212	—
Net earnings	7,389	12,493	14,887	15,890
Per Share Data:				
Basic earnings per share	\$ 0.72	\$ 1.22	\$ 1.37	\$ 1.47
Extraordinary items, net of tax effects	—	(0.04)	0.02	—
Net earnings per share	<u>\$ 0.72</u>	<u>\$ 1.18</u>	<u>\$ 1.39</u>	<u>\$ 1.47</u>
 Diluted earnings per share	 \$ 0.64	 \$ 1.10	 \$ 1.23	 \$ 1.35
Extraordinary items, net of tax effects	—	(0.04)	0.02	—
Net earnings per share	<u>\$ 0.64</u>	<u>\$ 1.06</u>	<u>\$ 1.25</u>	<u>\$ 1.35</u>

Quarterly and year-to-date computations of per share amounts are made independently. Therefore, the sum of per share amounts for the quarters may not agree with per share amounts for the year.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

Information required in response to this item is incorporated by reference from our definitive proxy statement for our 2003 Annual Meeting of Stockholders to be held on May 21, 2003, which proxy statement will be filed with the SEC not later than 120 days after year end. With the exception of the foregoing information and other information specifically incorporated by reference into this Form 10-K Report, our 2003 Proxy Statement is not being filed as a part of this report.

Item 11. Executive Compensation

Information required in response to this item is incorporated by reference from our definitive proxy statement for our 2003 Annual Meeting of Stockholders to be held on May 21, 2003, which proxy statement will be filed with the SEC not later than 120 days after year end.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Equity Compensation Plan Information

The following sets forth information as of December 31, 2002 about the number of shares of our common stock to be issued upon exercise of outstanding options and the number of shares of our common stock remaining available for future issuance under existing equity compensation plans for (1) plans approved by stockholders and (2) plans not approved by stockholders. We have no outstanding warrants or stock appreciation rights.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options (a)	Weighted-Average Exercise Price of Outstanding Options (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Equity Compensation Plans Approved by Stockholders	1,318,350	\$ 17.98	337,800
Equity Compensation Plans Not Approved by Stockholders	—	—	—
Total	<u>1,318,350</u>	<u>\$ 17.98</u>	<u>337,800</u>

At December 31, 2002, we did not have any equity compensation plans that had been adopted without stockholder approval.

Additional information required in response to this item is incorporated by reference from our definitive proxy statement for our 2003 Annual Meeting of Stockholders to be held on May 21, 2003, which proxy statement will be filed with the SEC not later than 120 days after year end.

Item 13. Certain Relationships and Related Transactions

Information required in response to this item is incorporated by reference from our definitive proxy statement for our 2003 Annual Meeting of Stockholders to be held on May 21, 2003, which proxy statement will be filed with the SEC not later than 120 days after year end.

Item 14. Controls and Procedures

In order to ensure that the information we must disclose in our filings with the SEC is recorded, processed, summarized and reported on a timely basis, we have formalized our disclosure controls and procedures. Our co-chief executive officers and principal financial officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rules 13a-14(c) and 15d-14(c), as of a date within 90 days prior to the filing date of this report (the "Evaluation Date"). Based on such evaluation, these officers have concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective in timely alerting them to material information relating to Meritage (and our consolidated subsidiaries) required to be included in our periodic SEC filings. Since the Evaluation Date, there have not been any significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the Evaluation Date.

Item 15. Principal Accountant Fees and Services

The following table presents fees for professional audit services rendered by our principal accountant, KPMG LLP, for the audit of our annual financial statements for 2002 and 2001, and fees billed for other services rendered by KPMG LLP.

	<u>2002</u>	<u>2001</u>
Audit fees	\$238,245	\$150,000
Audit related fees (1)	<u>134,074</u>	<u>110,808</u>
Audit and audit related fees	372,319	260,808
Tax fees (2)	119,893	240,845
All other fees (3)	<u>—</u>	<u>24,186</u>
Total fees	<u>\$ 492,212</u>	<u>\$525,839</u>

- (1) Audit related fees consisted principally of fees for services related to SEC filings and research, the 2002 acquisitions of Hammonds and Perma-Bilt, our 2002 equity offering and the audit of our 401(k) Plan.
- (2) Tax fees consisted of fees for income tax consulting and tax compliance, including preparation of our state and federal income tax returns.
- (3) All other fees consisted of fees for management advisory services.

PART IV

Item 16. Exhibits, Financial Statement Schedules and Reports on Form 8-K

Page or Method of Filing

(a) Financial Statements and Schedules

(i) Financial Statements:

(1) Report of KPMG LLP

Page 27

(2) Consolidated Financial Statements and Notes to Consolidated Financial Statements of the Company, including Consolidated Balance Sheets as of December 31, 2002 and 2001 and related Consolidated Statements of Earnings, Stockholders' Equity and Cash Flows for each of the years in the three-year period ended December 31, 2002

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(ii) Financial Statement Schedules:

Schedules have been omitted because of the absence of conditions under which they are required or because the required material

information is included in the Consolidated Financial Statements or Notes to the Consolidated Financial Statements included herein.

(b) Reports on Form 8-K

On October 9, 2002, we filed a Current Report on Form 8-K describing the completion of our acquisition of the homebuilding assets of Perma-Bilt Homes.

On October 23, 2002, we filed a Current Report on Form 8K/A amending Form 8-K dated October 7, 2002 to include transaction documents relating to our acquisition of Perma-Bilt Homes.

(c) Exhibits

Exhibit Number	Description	Page or Method of Filing
2.1	Agreement and Plan of Reorganization, dated as of September 13, 1996, by and among Homeplex, the Monterey Merging Companies and the Monterey Stockholders	Incorporated by reference to Exhibit 2 of Form S-4 Registration Statement No. 333-15937.
2.2	Agreement of Purchase and Sale of Assets, dated as of May 20, 1997, by and among Monterey, Legacy Homes, Ltd., Legacy Enterprises, Inc., and John and Eleanor Landon	Incorporated by reference to Exhibit 2 of Form 8-K/A dated June 18, 1997.
2.3	Agreement of Purchase and Sale of Assets, dated as of June 15, 1998, by and among the Company, Sterling Communities, S.H. Capital, Inc., Sterling Financial Investments, Inc., Steve Hafener and W. Leon Pyle	Incorporated by reference to Exhibit 2.2 of Form 10-Q for the quarterly period ended June 30, 1998.
2.4	Master Transaction Agreement, dated May 7, 2001, by and among the Company, Hancock-MTH Builders, Inc., Hancock-MTH Communities, Inc., HC Builders, Inc. and Hancock Communities, L.L.C.	Incorporated by reference to Exhibit 2.1 of Form 8-K dated May 10, 2001.
2.4.1	Amendment No. 1 to Master Transaction Agreement and Agreement of Purchase and Sale of Assets, dated May 30, 2001, by and between Meritage Corporation, Meritage-MTH Communities, Inc., HC Builders, Inc., Hancock Communities, L.L.C. and American Homes West, Incorporated	Incorporated by reference to Exhibit 2.1 of Form 8-K dated June 6, 2001.
2.5	Master Transaction Agreement, dated June 12, 2002, by and among the Company, MTH Homes-Texas, L.P., Hammonds Homes Ltd., Crystal City Land & Cattle, Ltd., Hammonds Homes I, LLC, Crystal City I, LLC and Ronnie D. Hammonds	Incorporated by reference to Exhibit 10.1 of Form 8-K dated July 12, 2002.
2.5.1	Amendment No. 1 to Master Transaction Agreement, dated June 12, 2002, by and among the Company, MTH Homes-Texas, L.P., Hammonds Homes Ltd., Crystal City Land & Cattle, Ltd., Hammonds Homes I, LLC, Crystal City I, LLC and Ronnie D. Hammonds	Incorporated by reference to Exhibit 10.2 of Form 8-K dated July 12, 2002.

2.6	Master Transaction Agreement, dated October 7, 2002, by and among the Company, MTH-homes Nevada, Inc., Perma-Bilt, A Nevada Corporation, and Zenith National Insurance Corp.	Incorporated by reference to Exhibit 10.1 of Form 8-K/A dated October 7, 2002.
3.1	Amendment to Articles of Incorporation	Incorporated by reference to Exhibit 3.1 of Form 10-Q for the quarterly period ended September 30, 1998.
3.2	Restated Articles of Incorporation	Incorporated by reference to Exhibit 3 of Form 8-K dated June 20, 2002.
3.3	Amended and Restated Bylaws	Incorporated by reference to Exhibit 3.3 of Form S-3 #333-58793.
4.1	Form of Specimen of Common Stock Certificate	Incorporated by reference to Exhibit 4.2 of Form S-3 dated May 1, 2002.
4.3	Indenture, dated May 31, 2001, by and among the Company, the Guarantors named therein and Wells Fargo Bank, N.A.	Incorporated by reference to Exhibit 4.1 of Form 8-K dated June 6, 2001.
4.3.1	First Supplemental Indenture, dated September 20, 2001, by and among the Company, Hulen Park Venture, LLC, Meritage Holdings, L.L.C., the Guarantors named therein and Wells Fargo Bank, N.A.	Filed herewith.
4.3.2	Second Supplemental Indenture, dated July 12, 2002, by and among the Company, MTH Homes-Texas, L.P., MTH-Texas GP II, Inc., MTH-Texas LP, II, Inc., the Guarantors named therein and Wells Fargo Bank, N.A.	Filed herewith.
4.3.3	Third Supplemental Indenture, dated October 21, 2002, by and among the Company, MTH-Homes Nevada, Inc., the Guarantors named therein and Wells Fargo Bank, N.A.	Filed herewith.
4.3.4	Fourth Supplemental Indenture, dated February 19, 2003 by and among the Company, MTH-Cavalier, LLC, the Guarantors named therein and Wells Fargo Bank, N.A.	Filed herewith.
10.1	\$250 Million Credit Agreement, dated December 12, 2002, by and among the Company, Guaranty Bank, Fleet National Bank, Bank One, NA and the other lenders thereto.	Filed herewith.
10.2	2001 Annual Incentive Plan*	Incorporated by reference to Exhibit B of the Proxy Statement for the 2001 Annual Meeting of Stockholders.
10.3	Employment Agreement, dated May 30, 2001, by and among the Company, Hancock MTH Builders, Inc., Hancock Communities, Inc. and Greg Hancock*	Incorporated by reference to Exhibit 10.2 of Form 8-K dated June 6, 2001.
10.4	Employment Agreement between the Company and Larry W. Seay*	Incorporated by reference to Exhibit 10.1 of Form 10-Q for the quarterly period ended September 30, 2001.

10.5	Change of Control Agreement between the Company and Steven J. Hilton*	Incorporated by reference to Exhibit 10.3 of Form 10-Q for the quarterly period ended March 30, 2000.
10.6	Change of Control Agreement between the Company and John R. Landon*	Incorporated by reference to Exhibit 10.4 of Form 10-Q for the quarterly period ended March 30, 2000.
10.7	Change of Control Agreement between the Company and Larry W. Seay*	Incorporated by reference to Exhibit 10.5 of Form 10-Q for the quarterly period ended March 30, 2000.
10.8	Change of Control Agreement between the Company and Richard T. Morgan*	Incorporated by reference to Exhibit 10.6 of Form 10-Q for the quarterly period ended March 30, 2000.
10.9	Deferred Bonus Agreement-2001 Award Year-between the Company and Larry W. Seay*	Incorporated by reference to Exhibit 10.2 of Form 8-K dated June 20, 2002.
10.10	Deferred Bonus Agreement-2002 Award Year-between the Company and Larry W. Seay*	Filed herewith.
10.11	Deferred Bonus Agreement-2001 Award Year-between the Company and Richard T. Morgan*	Incorporated by reference to Exhibit 10.3 of Form 8-K dated June 20, 2002.
10.12	Deferred Bonus Agreement-2001 Award Year-between the Company and Richard T. Morgan*	Filed herewith.
10.13	Registration Rights Agreement, dated February 21, 2003, by and among the Company, the Guarantors named therein, Deutsche Bank Securities, Inc., UBS Warburg LLC, Banc One Capital Markets, Inc. and Fleet Securities, Inc.	Incorporated by reference to Exhibit 10.1 of Form 8-K dated February 21, 2003.
14	Code of Ethics	Filed herewith.
21	List of Subsidiaries	Filed herewith.
23.1	Consent of KPMG LLP	Filed herewith.
24	Powers of Attorney	See signature page.
99.1	Certificate of Steven J. Hilton, Co-Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed herewith.
99.2	Certificate of John R. Landon, Co-Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed herewith.
99.3	Certificate of Larry W. Seay, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed herewith.

*Indicates a management contract or compensation plan.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, this 31st day of March 2003.

MERITAGE CORPORATION,
a Maryland Corporation

By /s/ STEVEN J. HILTON

Steven J. Hilton

Co-Chairman and Chief Executive Officer

By /s/ JOHN R. LANDON

John R. Landon

Co-Chairman and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven J. Hilton, John R. Landon and Larry W. Seay, and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Form 10-K Annual Report, and to file the same, with all exhibits thereto and other documents in connection therewith the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act of things requisite and necessary to be done in and about the premises, as fully and to all intents and purposes as he might or could do in person hereby ratifying and confirming all that said attorneys-in-fact and agents, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to these requirements of the Securities Exchange Act of 1934, the following persons on behalf of the registrant and in the capacities and on the dates indicated have signed this report on Form 10-K below:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ JOHN R. LANDON</u> John R. Landon	Co-Chairman and Chief Executive Officer	March 31, 2003
<u>/s/ STEVEN J. HILTON</u> Steven J. Hilton	Co-Chairman and Chief Executive Officer	March 31, 2003
<u>/s/ LARRY W. SEAY</u> Larry W. Seay	Chief Financial Officer, Vice President-Finance, and Secretary (Principal Financial Officer)	March 31, 2003
<u>/s/ VICKI L. BIGGS</u> Vicki L. Biggs	Controller and Chief Accounting Officer	March 31, 2003
<u>/s/ RAYMOND OPPEL</u> Raymond Oppel	Director	March 31, 2003
<u>/s/ ROBERT G. SARVER</u> Robert G. Sarver	Director	March 31, 2003
<u>/s/ C. TIMOTHY WHITE</u> C. Timothy White	Director	March 31, 2003
<u>/s/ PETER L. AX</u> Peter L. Ax	Director	March 31, 2003
<u>/s/ WILLIAM CAMPBELL</u> William Campbell	Director	March 31, 2003

CERTIFICATION OF THE CO-CHIEF EXECUTIVE OFFICER

I, John R. Landon, certify that:

1. I have reviewed this annual report on Form 10-K of Meritage Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
 - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 31, 2003

/s/ John R. Landon
John R. Landon
Co-Chief Executive Officer

CERTIFICATION OF THE CO-CHIEF EXECUTIVE OFFICER

I, Steven J. Hilton, certify that:

1. I have reviewed this annual report on Form 10-K of Meritage Corporation;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 31, 2003

/s/ Steven J. Hilton
Steven J. Hilton
Co-Chief Executive Officer

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER

I, Larry W. Seay, certify that:

1. I have reviewed this annual report on Form 10-K of Meritage Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
 - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 31, 2003

/s/ Larry W. Seay
Larry W. Seay
Chief Financial Officer

EXHIBIT 21

**MERITAGE CORPORATION
LIST OF SUBSIDIARIES**

Monterey Homes Arizona, Inc.
Monterey Homes Construction, Inc.
Meritage Homes of Arizona, Inc.
Meritage Paseo Crossing, LLC
Meritage Homes Construction, Inc.
Meritage Paseo Construction, LLC
Hancock-MTH Communities, Inc.
Hancock-MTH Builders, Inc.
MTH-Texas GP, Inc.
MTH-Texas GP II, Inc.
MTH-Texas LP, Inc.
MTH-Texas LP II, Inc.
MTH-Homes Texas, L.P.
MTH-Homes Nevada, Inc.
Meritage Holdings, L.L.C.
Meritage Homes of Northern California, Inc.
MTH Mortgage, LLC
MTH-Cavalier, LLC
Legacy/Monterey Homes, L.P.
Legacy Operating Company, L.P.
Hulen Park Venture, L.L.C.
Texas Home Mortgage Corporation

EXHIBIT 99.1

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Meritage Corporation (the "Company") on Form 10-K for the period ending December 31, 2002, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven J. Hilton, Co-Chief Executive Officer of the Company certify, to the best of my knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

**MERITAGE CORPORATION,
a Maryland Corporation**

By /s/ STEVEN J. HILTON

Steven J. Hilton

Co-Chief Executive Officer

March 31, 2003

EXHIBIT 99.2

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Meritage Corporation (the "Company") on Form 10-K for the period ending December 31, 2002, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John R. Landon, Co-Chief Executive Officer of the Company certify, to the best of my knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

**MERITAGE CORPORATION,
a Maryland Corporation**

By /s/ JOHN R. LANDON
John R. Landon
Co-Chief Executive Officer

March 31, 2003

EXHIBIT 99.3

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Meritage Corporation (the "Company") on Form 10-K for the period ending December 31, 2002, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Larry W. Seay, Chief Financial Officer of the Company certify, to the best of my knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

MERITAGE CORPORATION,
a Maryland Corporation

By /s/ LARRY W. SEAY

Larry W. Seay

Chief Financial Officer

March 31, 2003

CORPORATE INFORMATION

Corporate Offices:

Meritage Corporation
8501 East Princess Drive
Suite 290
Scottsdale, AZ 85255
480-609-3330

Meritage Corporation
4050 West Park Boulevard
Plano, TX 75093
800-210-6004

www.meritagehomes.com

Annual Meeting

May 21, 2003 at 9:00 a.m.
The Doubletree
Paradise Valley Resort
5401 N. Scottsdale Road
Scottsdale, AZ 85250

Transfer Agent & Registrar

Mellon Investor Services LLC
85 Challenger Road
Ridgefield Park, NJ 07600
www.melloninvestor.com
800-356-2017

Corporate Counsel

Snell & Wilmer LLP
Phoenix, AZ

Independent Auditors

KPMG LLP
Phoenix, AZ

Form 10-K

A copy of our Annual Report on Form 10-K, as filed with the United States Securities and Exchange Commission, is available without charge upon written request to:

Investor Relations

Vicki L. Biggs
8501 East Princess Drive
Suite 290
Scottsdale, AZ 85255
480-609-3330

Corporate Communications

Jane S. Hays
Meritage Corporation
4050 West Park Boulevard
Plano, TX 75093

Common Stock Price Range

Our common stock is traded on the New York Stock Exchange, Symbol MTH.

2002 Quarter Ended	High	Low	2001 Quarter Ended	High	Low
March 31	\$35.12	\$23.28	March 31	\$24.00	\$13.70
June 30	47.10	31.22	June 30	26.88	13.05
September 30	46.25	26.38	September 30	29.98	13.75
December 31	42.20	28.90	December 31	26.49	17.00

As of March 14, 2003, there were approximately 213 holders of record representing an estimated 3,200 beneficial owners of Meritage common stock.

The company does not pay dividends on its common stock.

DIRECTORS AND OFFICERS

Board of Directors

Steven J. Hilton
*Co-Chairman and
Chief Executive Officer*

John R. Landon
*Co-Chairman and
Chief Executive Officer*

Peter L. Ax (1) (2)
*Chief Executive Officer
Phoenix Capital
Management, LLC*

Raymond (Ray) Oppel (1) (2)
Private Investor

Robert G. Sarver (1) (2)
*Chairman & CEO
Western Alliance
Bancorporation*

William G. Campbell
*Managing Director
Knightsbridge Realty
Capital, Inc.*

C. Timothy White
*Partner
Greenberg Traurig, LLP*

Corporate Officers

Steven J. Hilton
*Co-Chairman and
Chief Executive Officer*

John R. Landon
*Co-Chairman and
Chief Executive Officer*

Larry W. Seay
*Chief Financial Officer
Vice President
Finance Secretary*

Richard T. Morgan
*Vice President
Treasurer*

Vicki L. Biggs
*Vice President
Controller*

**Legacy Homes/
Hammonds Homes/
Monterey Homes-Texas**
www.legacy-homes.com
www.hammondshomes.com
www.montereyhomestexas.com

Stewart H. Parker
Regional President-North Texas

David C. Rich
Division President-DFW West

Randal Kirk Perrin
Division President-DFW South

Richard L. Harvey
Regional President-Central Texas

Wesley J. Peoples
Division President-Austin

Michael J. Pizzitola
Regional President-South Texas

Jane S. Hays
*Vice President-Corporate
Development*

Richard T. Morgan
*Vice President-Finance
Chief Financial Officer*

Meritage Homes-California
www.meritagehomes-ca.com

Robert D. McLaughlin
Regional President

Michael V. Anderson
Division President-Sacramento

William H. Mayben
*Division President-San
Francisco/East Bay*

Bruce S. Garretson
*Vice President-CFO
California Region*

**Monterey Homes/
Hancock Communities/
Meritage Homes-Arizona**
www.montereyhomes.com
www.hancockcommunities.com
www.meritagehomesphoenix.com

David A. Walls
*Division President
Monterey Homes-Phoenix*

Jeffrey R. Grobstein
*Division President
Monterey Homes-Tucson*

James Arneson
*Chief Operating Officer
Hancock Communities
Meritage Homes - Phoenix*

Roger A. Zetah
*Vice President-
Chief Financial Officer
Arizona Region*

Perma-Bilt Homes-Nevada
www.permabilthomes.com

Daniel Schwartz
Division President

(1) Audit Committee

(2) Compensation Committee



WENDY S. CABRAL

4500 P.G.A. Boulevard, Suite 303B
Palm Beach Gardens, Florida 33418
Tel. 407-624-8770 Fax 407-624-9988

August 27, 2003

Lindy Bauer, Environmental Program Coordinator
Maricopa Association of Governments
302 North 1st Avenue, Suite 300
Phoenix, AZ 85003

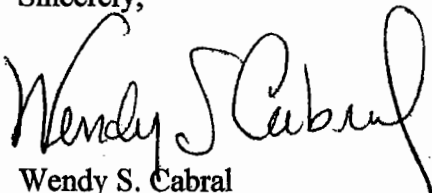
**RE: Palo Verde Road Waste Water Treatment Facility
Financial Statement for The Newport Group
For Silver Rock Developments, Buckeye, Arizona**

Dear Sirs:

As you know, The Newport Group is the developer of Silver Rock in Buckeye, Arizona. The Newport Group is comprised of three partners, with the financial partner being Wendy S. Cabral and affiliated entities. This property is being purchased in an option arrangement over time with The Newport Group having all development rights and decision-making abilities for the Silver Rock project. We are developing the sewer plant in conjunction with Westwind and its developer, Meritage Homes.

If you have any questions regarding Silver Rock or The Newport Group, please feel free to contact Robert Napoli directly at (480) 951-2227 in our Scottsdale office.

Sincerely,



Wendy S. Cabral

cc: Robert Napoli, Newport Development
Via Facsimile (480) 991-2888

WENDY S. CABRAL

**Statement of Financial Condition and
Supplementary Information
December 31, 2002**



MELANSON HEATH & COMPANY, PC

CERTIFIED PUBLIC ACCOUNTANTS
MANAGEMENT ADVISORS

11 Trafalgar Square • Suite 101
Nashua, NH 03063-1974
Tel (603)882-1111 • Fax (603)882-9456
melansonheath.com

Wendy S. Cabral
Palm Beach Gardens, FL

We have compiled the accompanying statement of financial condition of Wendy S. Cabral as of December 31, 2002, and the accompanying supplemental information contained in the Schedule of Closely Held Businesses, which is presented only for supplementary analysis purposes, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The statement of financial condition is intended to present the assets of Wendy S. Cabral at estimated current values and her liabilities at estimated current amounts.

A compilation is limited to presenting in the form of financial statements and supplementary schedules information that is the representation of the individual whose financial statements are presented. We have not audited or reviewed the accompanying statement of financial condition and supplementary schedule and, accordingly, do not express an opinion or any other form of assurance on it.

Wendy S. Cabral has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the statement of financial condition, they might influence the user's conclusions about the financial position of Wendy S. Cabral. Accordingly, this statement of financial condition is not designed for those who are not informed about such matters.

Melanson Heath & Company, PC

Nashua, New Hampshire
April 28, 2003

Additional Offices:

Andover MA • Greenfield MA • Fitchburg MA

WENDY S. CABRAL

**Statement of Financial Condition
December 31, 2002**

ASSETS

Cash	\$ 282,000
Marketable securities	370,000
Annuities and CSV of life insurance	1,060,000
Land investments	6,630,000
Real estate - residence	1,000,000
Investment in closely held businesses	68,515,240
Personal property	<u>173,000</u>

TOTAL ASSETS \$ 78,030,240

LIABILITIES

Notes payable	\$ 5,411,000
Current estimated income taxes	<u>600,000</u>

Total Liabilities 6,011,000

NET WORTH 72,019,240

TOTAL LIABILITIES AND NET WORTH \$ 78,030,240

See accountants' report.

WENDY S. CABRAL

**Schedule of Closely Held Businesses
December 31, 2002**

<u>Company name and activity</u>	<u>Estimated fair market value (*)</u>	<u>Ownership percentage</u>	<u>Wendy S. Cabral share</u>
Cabral Holdings, L.P.	\$ 39,726,000	99.00%	\$ 39,328,740
Flagler Properties, Inc.	337,000	50.00%	168,500
St. James Financial Services, Inc.	446,000	50.00%	223,000
Westmount Financial Services, Inc.	<u>28,795,000</u>	100.00%	<u>28,795,000</u>
 Total Closely Held Businesses	 <u>\$ 69,304,000</u>		 <u>\$ 68,515,240</u>

(*) Estimated fair market value is shown net of estimated liabilities and debts.

See accountants' report.

WESTMOUNT FINANCIAL SERVICES, INC.

**Financial Statements
and Supplementary Information**

For the Year Ended December 31, 2002

(With Accountants' Compilation Report Thereon)

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MELANSON HEATH & COMPANY, PC

CERTIFIED PUBLIC ACCOUNTANTS
MANAGEMENT ADVISORS

11 Trafalgar Square • Suite 101
Nashua, NH 03063-1974
Tel (603)882-1111 • Fax (603)882-9456
melansonheath.com

To the Stockholder
Westmount Financial Services, Inc.
Scottsdale, Arizona

We have compiled the accompanying balance sheet of Westmount Financial Services, Inc. as of December 31, 2002, and the related statements of income and retained earnings, and cash flows and accompanying supplementary information for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements and supplementary schedules, information that is the representation of management. We have not audited or reviewed the accompanying financial statements and supplementary schedules and, accordingly, do not express an opinion or any other form of assurance on them.

Melanson Heath & Company P.C.

Nashua, New Hampshire
June 18, 2003

WESTMOUNT FINANCIAL SERVICES, INC.

Balance Sheet
December 31, 2002

ASSETS

Current Assets:

Cash and cash equivalents	\$ 3,003
Notes receivable, related parties (note 5)	2,220,668
Total Current Assets	<u>2,223,671</u>

Property and Equipment, net	38,133
Investments	5,310,342
Other Assets, net	<u>194</u>

TOTAL ASSETS \$ 7,572,340

LIABILITIES AND STOCKHOLDER'S EQUITY

Current Liabilities:

Other current liabilities	\$ 2,116
Deferred revenue	431,272
Notes payable, related parties (note 5)	6,486,744
Total Current Liabilities	<u>6,920,132</u>

Stockholder's Equity:

Common stock (no par value, 100 shares authorized, issued and outstanding)	200,000
Additional paid in capital	355,609
Retained earnings	96,599
Total Stockholder's Equity	<u>652,208</u>

TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY \$ 7,572,340

See accompanying notes and accountants' report.

WESTMOUNT FINANCIAL SERVICES, INC.

Statement of Income and Retained Earnings For the Year Ended December 31, 2002

Revenues:	
Income from investments	\$ 849,766
Other income	<u>35,620</u>
Total revenues	885,386
Operating Expenses (page 9)	<u>45,231</u>
Income from Operations	840,155
Other Income and (Expenses):	
Gain on sale of fixed assets	22,620
Interest expense	<u>(243,756)</u>
Total Other Income and (Expenses)	<u>(221,136)</u>
Net Income	619,019
Retained Earnings, beginning	2,212
Distributions	<u>(524,632)</u>
Retained Earnings, ending	<u><u>\$ 96,599</u></u>

See accompanying notes and accountants' report.

WESTMOUNT FINANCIAL SERVICES, INC.

Statement of Cash Flows For the Year Ended December 31, 2002

Cash Flows From Operating Activities:

Net income	\$ 619,019
Adjustments to reconcile net income to net cash provided by operating activities:	
Gain on sale of fixed assets	22,620
Depreciation and amortization	1,856
Other assets	1,000
Other current liabilities	<u>429,924</u>
Net cash provided by operating activities	1,074,419

Cash Flows From Investing Activities:

Equity investments, net	(2,496,350)
Related party loans, net	<u>1,734,664</u>
Net cash used by investing activities	(761,686)

Cash Flows From Financing Activities:

Distributions	(524,632)
Additional paid in capital	<u>204,068</u>
Net cash used by financing activities	<u>(320,564)</u>

Net Decrease	(7,831)
Cash and Cash Equivalents, beginning	<u>10,834</u>
Cash and Cash Equivalents, ending	<u><u>\$ 3,003</u></u>

Supplemental Disclosures of Cash Flow Information:

Cash paid during the year for:	
Interest	\$ 243,756

See accompanying notes and accountants' report.

WESTMOUNT FINANCIAL SERVICES, INC.

Notes to the Financial Statements December 31, 2002

1. Nature of Business:

Westmount Financial Services, Inc. (the Company), is engaged in investing in companies with income producing properties or in the development of real estate. The Company's investments cover properties in a wide geographic area within the United States of America.

2. Summary of Significant Accounting Policies:

The following is a summary of significant accounting policies of the Company used in preparing and presenting the accompanying financial statements:

Method of Accounting

The Company uses the accrual method of accounting for book purposes. This method recognizes revenues and expenses and the related assets and liabilities when earned or incurred without regard to the time of receipt or payment.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all cash accounts with a maturity of three months or less to be cash equivalents. At December 31, 2002 cash consists of deposits in checking and savings accounts; there are no cash equivalents.

Property and Equipment and Depreciation

Depreciation is provided on the straight line and accelerated methods over the estimated useful lives of the respective assets for both book and tax purposes. The differences between book and tax depreciation are immaterial to the financial statements taken as a whole.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Income Taxes

The Company, with the consent of its stockholder, has elected under the Internal Revenue Code to be an S corporation. In lieu of corporation income taxes the stockholders of an S corporation are taxed on their proportionate share of the Company's taxable income. Therefore, no provision or liability for federal income taxes has been included in the financial statements. State taxes have been provided for at statutory rates, when applicable.

Fair Value of Financial Instruments

Statement of Financial Accounting Standards No. 107, Disclosures about Fair Value of Financial Instruments, requires disclosure of fair value information about financial instruments, whether or not recorded in the statement of financial condition. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. These techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Statement No. 107 excluded certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts of cash and cash equivalents approximate those assets' fair values.

Investments: Fair values of investments in income producing properties are determined using current market analysis, as estimated by management, less outstanding obligations.

3. **Property and Equipment:**

Property and equipment as of December 31, 2002 is summarized below:

Buildings and improvements	\$ 49,501
Less: accumulated depreciation	(11,368)
Property and Equipment, net	\$ <u>38,133</u>

4. **Investments:**

Investments consist of interests in limited partnerships and limited liability companies and are accounted for under the equity method. As of December 31, 2002 those investments totaled \$5,310,342 and are detailed as follows:

<u>Name of Entity</u>	<u>%Ownership</u>	<u>Type of Entity</u>
The Newport Groups, LLC	33.3%	Limited Liability Companies
The Foresight Group Holdings, LLC	44%	Limited Liability Companies
GFI-Big Joe, LLC	47.5%	Limited Liability Company
170-186 Main Street, LLC	50%	Limited Liability Company
324 Clark Street, LLC	50%	Limited Liability Company
Bra-West Cypress, LLC	50%	Limited Liability Company
GFI-Merrimack, LLC	50%	Limited Liability Company
GFI-Milford, LLC	50%	Limited Liability Company
GFI-Littleton, LLC	50%	Limited Liability Company
GFI-Telluride, LLC	50%	Limited Liability Company
GFI-Tyngsboro, LLC	50%	Limited Liability Company
GFI-Westminster, LLC	50%	Limited Liability Company
Clipper Capital, LLC	50%	Limited Liability Company
Hoit Mill, LP	50%	Limited Partnership
Indian River Development, LLC	50%	Limited Liability Company
Meadowbrook Acres, LLC	50%	Limited Liability Company
Pagewood Associates, LP	50%	Limited Partnership
Shirley Wayside, LP	50%	Limited Partnership
Southwest Partners, LLC	50%	Limited Liability Company
Ware Oakwood, LP	50%	Limited Partnership
Westfield Arbor, LP	50%	Limited Partnership
Worth Financial Group, LLC	50%	Limited Liability Company
32 Brickstone, LLC	99%	Limited Liability Company
Portsmouth Place Apts., LLC	99%	Limited Liability Company
Waterfront Holdings, LLC	99%	Limited Liability Company

(continued)

(continued)

Based on management's assumptions, the estimated fair values of the Company's financial instruments, none of which are held for trading purposes, are detailed on the schedule of investments on page 10. Estimated net equity at December 31, 2002 was \$33,457,840.

As discussed in Note 5, the Company has several notes payable to related parties, of which \$5,380,809 was outstanding at December 31, 2002 to the companies listed above.

5. **Related Party Transactions:**

The Company has several notes payable to related parties. These notes are payable upon demand and carry various interest rates with no formal repayment terms. The total amount of related party notes payable at December 31, 2002 was \$6,486,744.

The Company also has several notes receivable from related parties. These notes carry various interest rates with no formal repayment terms. The total amount of related party notes receivable at December 31, 2002 was \$2,220,668.

WESTMOUNT FINANCIAL SERVICES, INC.

**Schedule of Operating Expenses
For the Year Ended December 31, 2002**

Other taxes	\$ 11,359
Professional fees	10,268
Vehicle expenses	10,163
Condo fees	4,117
Miscellaneous expenses	2,869
Repairs and maintenance	1,966
Depreciation	1,800
Supplies	1,025
Telephone	763
Licenses and fees	379
Bank service charges	316
Filing fees	150
Amortization	<u>56</u>
Total Operating Expenses	\$ <u><u>45,231</u></u>

See accountants' report.

WESTMOUNT FINANCIAL SERVICES, INC.

Schedule of Investments For the Year Ended December 31, 2002

Company name	Estimated fair market value (net of debt)	Ownership percentage	Westmount Financial Services, Inc. share
170-186 Main Street, LLC	\$ 1,311,408	50.0%	\$ 655,704
32 Brickstone, LLC	870,869	99.0%	862,160
324 Clark Street, LLC	1,355,503	50.0%	677,752
Bra-West Cypress, LLC	1,896,378	50.0%	948,189
GFI/Big Joe, LLC	5,704,704	47.5%	2,709,734
GFI/Merrimack, LLC	900,000	50.0%	492,739
GFI/Milford, LLC	95,877	50.0%	47,939
GFI/Littleton, LLC	2,870,800	50.0%	2,094,036
GFI/Telluride, LLC	3,681,454	50.0%	2,555,029
GFI/Tyngsboro, LLC	1,880,230	50.0%	1,153,507
GFI/Westminster, LLC	6,057,273	50.0%	3,669,093
Clipper Capital, LLC	1,800,917	50.0%	900,459
The Foresight Group Holdings, LLC	10,977,539	44.0%	4,830,117
Hoit Mill, LP	425,226	50.0%	212,613
Indian River Lot 1	160,000	100.0%	160,000
Meadowbrook Acres, LLC	788,385	50.0%	394,193
Mt. Laurel	263,316	50.0%	131,658
Pagewood Associates, LP	666,956	50.0%	333,478
Portsmouth Place Apts., LLC	1,083,011	99.0%	1,072,181
Scottsdale - Bow	-	50.0%	-
Shirley Wayside, LP	718,695	50.0%	359,348
Southwest Partners	1,990,923	50.0%	995,462
The Newport Group of Companies	20,986,871	33.3%	6,995,624
Ware Oakwood, LP	520,397	50.0%	260,199
Waterfront Holdings, LLC	563,300	99.0%	557,667
Westfield Arbor, LP	240,446	50.0%	120,223
WFS Operations	165,000	100.0%	165,000
Worth Financial Group, LLC	207,480	50.0%	103,740
Totals	\$ <u>68,182,958</u>		\$ <u>33,457,840</u>

See accountants' report.

WESTMOUNT FINANCIAL LIMITED PARTNERSHIP

**Financial Statements
and Supplementary Information**

For the Year Ended December 31, 2001

(With Accountants' Review Report Thereon)

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MELANSON HEATH & COMPANY, PC

CERTIFIED PUBLIC ACCOUNTANTS
MANAGEMENT ADVISORS

11 Trafagar Square • Suite 101
Nashua, NH 03063-1974
Tel (603)882-1111 • Fax (603)882-9456

To the General Partner
Westmount Financial Limited Partnership
Scottsdale, Arizona

We have reviewed the accompanying balance sheet of Westmount Financial Limited Partnership as of December 31, 2001, and the related statements of income, partners' capital, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of Westmount Financial Limited Partnership.

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

Our review was made for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles. The information included in the accompanying supplemental Schedule of Operating Expenses is presented only for supplementary analysis purposes. Such information has been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements and we are not aware of any material modifications that should be made thereto.

Melanson Heath & Company, PC

Nashua, New Hampshire
May 2, 2002

Additional Offices:

Andover, MA • Greenfield, MA • Ellsworth, ME

WESTMOUNT FINANCIAL LIMITED PARTNERSHIP

Balance Sheet
December 31, 2001

ASSETS

Current Assets:

Cash and cash equivalents	\$ 1,098,404
Mortgage loans receivable, net	7,392,863
Construction loans receivable	605,277
Total Current Assets	<u>9,096,544</u>

Property and Equipment, net 17,395

Other Assets:

Loans receivable, related parties	19,152,053
Investments	236,604
Total Other Assets	<u>19,388,657</u>

TOTAL ASSETS \$ 28,502,596

LIABILITIES AND PARTNERS' CAPITAL

Current Liabilities:

Line of credit payable	1,500,000
Deferred revenue	1,693,972
Total Current Liabilities	<u>3,193,972</u>

Due to Related Parties 3,052,916

Partners' Capital 22,255,708

TOTAL LIABILITIES AND PARTNERS' CAPITAL \$ 28,502,596

See accompanying notes and accountants' report.

WESTMOUNT FINANCIAL LIMITED PARTNERSHIP

Statement of Income For the Year Ended December 31, 2001

		<u>% of Sales</u>
Revenues:		
Interest and fees on loans	\$ 2,339,350	83.6 %
Points and financing fees	457,809	16.4
	<u>2,797,159</u>	<u>100.0</u>
Interest Expense	<u>464,391</u>	<u>16.6</u>
Net Interest Income	2,332,768	83.4
Operating Expenses (page 11)	<u>322,694</u>	<u>11.5</u>
Income from Operations	2,010,074	71.9
Other Income and (Expenses):		
Income from investments	250,600	9.0
Provision for loan losses	<u>(179,225)</u>	<u>(6.4)</u>
Total Other Income and (Expenses)	<u>71,375</u>	<u>2.6</u>
Net Income	<u>\$ 2,081,449</u>	<u>74.5 %</u>

See accompanying notes and accountants' report.

WESTMOUNT FINANCIAL LIMITED PARTNERSHIP

Statement of Partners' Capital For the Year Ended December 31, 2001

	<u>Limited Partners</u>	<u>General Partner</u>	<u>Total</u>
Beginning balance, January 1, 2001	\$ 18,375,530	\$ 201,797	\$ 18,577,327
Net Income	2,060,635	20,814	2,081,449
Add Partner Contributions, net of distributions	<u>1,596,932</u>	<u>-</u>	<u>1,596,932</u>
Ending balance, December 31, 2001	<u>\$ 22,033,097</u>	<u>\$ 222,611</u>	<u>\$ 22,255,708</u>

See accompanying notes and accountants' report.

WESTMOUNT FINANCIAL LIMITED PARTNERSHIP

Statement of Cash Flows For the Year Ended December 31, 2001

Cash Flows From Operating Activities:

Net income	\$ 2,081,449
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation	5,069
Deferred revenues	435,309
Related party loans, net	(15,297,753)
Issuance of mortgages, net of repayments	8,438,034
	<hr/>
Net cash used by operating activities	(4,337,892)

Cash Flows From Investing Activities:

Purchases of fixed assets	(2,119)
Equity investments, net	679,051
	<hr/>
Net cash provided by investing activities	676,932

Cash Flows From Financing Activities:

Repayments on line of credit	(1,500,000)
Capital contributions by partners, net of distributions	1,596,932
	<hr/>
Net cash provided by financing activities	96,932
	<hr/>
Net Decrease	(3,564,028)
Cash and Cash Equivalents, beginning	4,662,432
	<hr/>
Cash and Cash Equivalents, ending	\$ 1,098,404

Supplemental Disclosures of Cash Flow Information:

Cash paid during the year for:	
Interest	\$ 464,391

See accompanying notes and accountants' report.

WESTMOUNT FINANCIAL LIMITED PARTNERSHIP

Notes to the Financial Statements
December 31, 2001

1. **Nature of Business:**

Westmount Financial Limited Partnership (the Partnership), is engaged in the funding of first mortgage bridge loans secured primarily by income producing properties. Additionally, the Partnership is a participation lender in the acquisition and construction of single family homes and residential subdivisions. The Partnership's mortgages cover properties in a wide geographic area. After the close of business on December 31, 2000, the Partnership was merged into a new Nevada limited partnership, chartered as Westmount Financial Limited Partnership.

2. **Summary of Significant Accounting Policies:**

The following is a summary of significant accounting policies of the Partnership used in preparing and presenting the accompanying financial statements:

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Partnership considers all cash accounts with a maturity of three months or less to be cash equivalents. At December 31, 2001 cash consists of deposits in checking accounts, repurchase agreements, and savings accounts; there are no cash equivalents.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Mortgage Loans Receivable

Loans are stated at face value. All mortgage loans are collateralized by either land, residential, industrial, or commercial property.

Certain loan origination fees, as well as certain direct origination costs, are deferred and recognized in income when payment is received.

The allowance for loan losses typically is maintained at a level which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectibility of the loan portfolio, including the nature of the portfolio, value of collateral, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. The allowance is increased by a provision for loan losses, which is charged to expense, and reduced by charge-offs, net of recoveries.

Property and Equipment and Depreciation

Depreciation is provided on the straight-line and accelerated methods over the estimated useful lives of the respective assets for both book and tax purposes. The difference between book and income tax depreciation is immaterial to the financial statements taken as a whole.

Income Taxes

All effects of the partnership's income or loss are passed through to the partners individually. Therefore, no provision for income taxes is reflected in the accompanying financial statements.

Fair Value of Financial Instruments

Statement of Financial Accounting Standards No. 107, Disclosures about Fair Value of Financial Instruments, requires disclosure of fair value information about financial instruments, whether or not recorded in the financial statements. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. These techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Statement No. 107 excluded certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Partnership.

The following methods and assumptions were used by the Partnership in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts of cash and cash equivalents approximate those assets' fair values.

Investments: Investments are stated at cost. Fair values for investments are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. Fair values of investments in income producing properties are determined using current market analysis less outstanding obligations.

Loans: Fair values of mortgage loans with no significant credit risk (as determined by management) are based on carrying amounts. The carrying amount of accrued interest receivable approximates its fair value.

3. **Mortgage Loans Receivable:**

Mortgage loans receivable consists of commercial bridge loans and lender acquisition loans secured by income producing properties and residential subdivisions. The loans are stated in aggregate and carry varying interest rates and maturity dates. Mortgage loans receivable at December 31, 2001 totaled \$7,742,863 net of an allowance for uncollectible accounts of \$350,000. The Partnership also has several construction loans receivable, of which the total at December 31, 2001 was \$605,277.

4. **Property and Equipment:**

Property and equipment as of December 31, 2001 is summarized below:

Office equipment and furniture	\$ 12,202
Vehicle	<u>28,405</u>
Total	40,607
Less: accumulated depreciation	<u>(23,212)</u>
Property and Equipment, net	\$ <u>17,395</u>

5. **Investments:**

Investments consist of securities, interests in limited partnerships, and interests in limited liability companies. As of December 31, 2001, investments (on the equity method) totaled \$236,604.

6. **Deferred Revenue:**

Deferred revenue consists of loan origination fees and costs associated with issuing mortgage loans, and are recognized over the lives of the related loans. As of December 31, 2001, deferred revenues totaled \$1,693,972.

7. **Related Party Transactions:**

The Partnership has made several loans to related companies and individuals. These loans carry interest rates ranging between 6% and 10%. Some of these loans have formal repayment terms with varying amounts. The amount of related party loans receivable at December 31, 2001 was \$19,152,053.

The Partnership also has notes payable to related companies and to one limited partner. These notes carry interest rates varying between 6% and 10% and have no formal repayment terms. However, interest on outstanding balances is paid. The total amount of related party notes payable at December 31, 2001 was \$3,052,916.

8. **Line of Credit:**

The Partnership has a line of credit with Colonial Bank with a maximum borrowing limit of \$1,500,000. The line is secured by substantially all the partnership assets and requires monthly interest payments at prime plus 1.25%, which was at 6% at year end. At December 31, 2001 the outstanding balance was \$1,500,000.

9. **Concentration of Credit Risk:**

The Partnership maintains cash in bank deposit accounts at various financial institutions. The balances, at times, may exceed federally insured limits. At December 31, 2001 the Partnership deposits exceeded the insured limits by approximately \$835,092. The Partnership has a repurchase account arrangement with the bank. This arrangement reduces credit risk with respect to cash balances.

10. **Operating Leases:**

The Partnership rents its operating facilities as a tenant at will. The agreement requires monthly payments. Total rent expense for the year ended December 31, 2001 was \$11,893.

The Partnership also leases a vehicle under a non-cancelable twelve month operating lease agreement. The lease, which requires monthly payments of \$780 expired in December, 2001. Vehicle lease payments for the year ended December 31, 2001 totaled \$12,558.

Appendix C

Letters

ENVIRONMENTAL SERVICES
DEPARTMENT

Albert F. Brown, RS, MPA, Director

1001 N. Central Avenue, Suite 150
Phoenix, Arizona 85004



WATER AND WASTE MANAGEMENT
DIVISION

John A. Power, PE, Division Manager

(602) 506-6666
FAX (602) 506-6925
TT (602) 506-6704

November 19, 2004

Maricopa Association of Governments
302 North 1st Avenue, Suite 300
Phoenix, Arizona 85003

Attention: Ms. Lindy Bauer, Environmental Program Coordinator
Re: Town of Buckeye Proposed 208 Amendment for Palo Verde Road WWTP

Dear Ms. Bauer:

RBF Consulting has submitted a proposed 208 Amendment to the Maricopa County Environmental Services Department (MCESD) for the Town of Buckeye Palo Verde Road Wastewater Treatment Plant, which will serve the Westwind and Silver Rock Developments. The developments will be constructed in an area within the Town of Buckeye, generally between Johnson Road and Turner Road, south of Van Buren, and one half mile north of Southern Avenue.

In accordance with the MAG 208 Water Quality Management Plan, the proposed 208 Amendment for the facility was submitted to this Department for comment, since the facility is located within three miles of the unincorporated area of Maricopa County.

The proposed 208 Amendment was originally submitted June 24, 2004, and revised on November 19, 2004. Based on a review of the revised document, the Maricopa County Environmental Services Department, Water and Waste Management Division acknowledges that the proposed Town of Buckeye Palo Verde Road WWTP is not in conflict with Maricopa County plans for the area.

MCESD provides this letter of support, conditioned on final execution of the Agreement with the Town of Buckeye, whereby the Town of Buckeye will be the permanent owner of the proposed wastewater collection, treatment, and disposal facilities upon completion of construction of the first phase of the facilities and prior to startup. As such, the Town will be the responsible party for the MCESD Annual Operating Permit, as well as appropriate Federal, State, and County discharge / recharge / reuse permits.

Page 2 of 2

November 19, 2004

Ms. Lindy Bauer

Town of Buckeye Palo Verde Road WWTP

Should the Town of Buckeye not be the owner of the wastewater facilities, this Department will withdraw its support for the project.

Please note that MCESD has not reviewed, nor approved, the design of the facilities as part of the 208 Review. Any technical issues that remain will need to be resolved during the design phase of the project. Approval to Construct and Approval of Construction must be obtained from this Department prior to start of construction and startup, respectively.

If you have any questions or comments, please feel free to contact Mr. Dale Bodiya, PE, or myself, at 506-6666.

Sincerely,

A handwritten signature in black ink, appearing to read "John A. Power PE". The signature is fluid and cursive, with the initials "JAP" being prominent.

John A. Power, PE

Manager, Water and Waste Management Division

cc:

Mr. Albert F. Brown, RS, MPA, Director, MC Environmental Services Department

Mr. Dale Bodiya, PE, Manager, Water / Wastewater Treatment Section, MCESD

ADEQ, Manager, Water Permits and Plan Review Section

Mr. Brandon Squire, PE, RBF Consultants

Mr. Carroll Reynolds, Town Manager, Town of Buckeye

File

Appendix D

Proposed Construction Phases Report

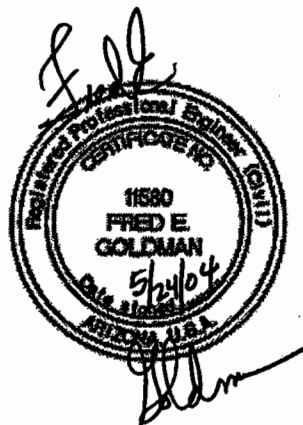
Kennedy/Jenks Consultants

3101 N. Central Ave, Suite 1470
Phoenix, AZ 85012
602-274-0886
602-274-0764 (Fax)

PALO VERDE ROAD WWTP

Proposed Construction Phases

May 2004



Prepared for

S. D. Construction, LLC

3040 N. 44th Street, Suite 3
Phoenix, AZ 85018

K/J Project No. 047806.00

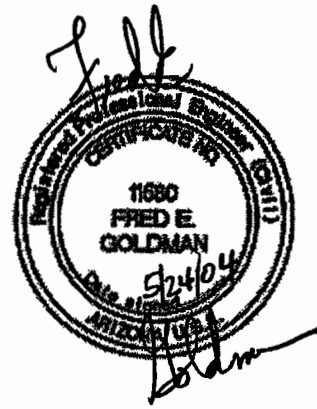


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Section 1: Introduction

The purpose of this engineering report is to propose a plant phasing plan to be included in a 208 Amendment submitted to the Maricopa Association of Governments for the proposed Palo Verde Road Wastewater Treatment Plant (PVRWWTP) located in the western portion of town boundaries. The proposed treatment plant will serve the Westwind and SilverRock master planned communities and an area that surrounds the existing Buckeye Airport with a combined projected wastewater flow of 10.2 mgd.

This report presents the following information:

- An evaluation of the required land needed for the treatment facilities, including allowance for odor and noise setbacks in accordance with Arizona Department of Environmental Quality – Water Pollution Control regulations for the ultimate 10.2 mgd facility.
- An initial phase treatment plant (Phase 1A) with a capacity of 0.50 mgd with provisions to provide facilities that would be incorporated into the Phase I treatment plant.
- A Phase I - 1.0 mgd treatment plant layout and description.
- A layout and description of the proposed 10.2 mgd treatment facility.
- Discussion of phasing strategy

The design philosophy is rooted on processes that will produce A+ effluent for all phases of operation including early low flow conditions and the ultimate capacity of 10.2 mgd. This will be accomplished by designing a first phase 1 mgd plant with an interim phase 1A of 0.5 mgd. Batch reactors will be used up to 2 mgd. Fine bubble diffusers will be used for efficient oxygen transfer except for the interim Phase 1A plant (which uses future aerobic digesters as batch reactors). Secondary clarifiers and anoxic mixed tanks will be added to increase capacity to 4 mgd and 8 mgd and convert the process to MLE (activated sludge with aerobic and mixed anoxic tanks with internal recycle to provide biological nitrogen removal through nitrification and denitrification). Primary clarifiers will be added for the final capacity expansion to accommodate the ultimate flow up to 10.2 mgd. The solids handling system will be modified as flows increase. Aerobic digestion will be used up to 8 mgd when the digesters will be converted to anaerobic digesters with the addition of sludge thickening. Tertiary filtration and UV disinfection will be used for all phases.

Section 2: Site Requirements

2.1 Location

The proposed MAG 208 Water Quality Management Plan Amendment Application sets forth a proposed PVRWWTP service area that is projected to include 33,976 equivalent dwelling units generating 10.2 mgd when fully developed. The service area is located between Johnson Road on the West and Turner Road on the East (although some projects east of Turner Rd may be serviced by this plant), extending north to I-10 (and approximately 1 mile north of I-10 in some areas) and to Southern Avenue on the South.

A proposed plant site is located immediately East of Palo Verde Road approximately ½ mile north of Southern Road.

2.2 Setback Requirements

Setback requirements for wastewater treatment facilities are provided in the Department of Environmental Quality Regulations and are dependent on capacity and whether or not odor and noise control are provided for primary, secondary and solids handling facilities. The required setback is 350 feet for the 10.2 mgd facility if odor and noise control are provided for all treatment components.

Figure 1 shows the ultimate 10.2 mgd facility with required setbacks.

2.3 Effluent Management

Effluent produced by the PVRWWTP will be pumped to groundwater recharge basins located near the Hassayampa River. Class A+ effluent could also be used for irrigation or direct discharge to the river if required in the future (and permits were obtained). This would optimize the recharge program. An AZPDES permit will be obtained to allow the direct discharge to the river as an emergency measure. Effluent holding basins will be located at the recharge site.

Section 3: Initial 1 MGD Phase

3.1 Introduction

The proposed Palo Verde Road WWTP will serve the Westwind and Silver Rock Master Planned communities and future development around the Buckeye Airport. Starting up a wastewater plant with very low flow is always difficult. Plants require about 20% of the design flow to run properly. The flows will be quite low when the projects start up. We have observed flows per home in the range of 150 – 180 gpd/home in new developments. This means that over 1,000 homes will need to be sold to provide 200,000 gpd or 20% of a first phase 1 mgd wastewater treatment plant.

In order to accommodate the low flows we are suggesting a Phase 1A 500,000 gpd wastewater treatment plant. The plant will be designed to accommodate extremely low flows while producing an A+ effluent. The plant will also have elements that will be included in the Phase 1 – 1 MGD WWTP.

The plan is to prepare design plans and permits for the Phase 1A and Phase 1 plants. When flows reach 300,000 gpd construction can immediately begin on the elements needed to reach the 1 mgd capacity without any delays in obtaining additional permits.

Effluent will be pumped to recharge basins that will be constructed near the Hassayampa River.

3.2 Phase 1A 0.5 mgd Plant (Figure 2)

The Phase 1A plant will have capacity to treat 500,000 gpd. Temporary bolted steel tanks will be used for aerated sludge storage and post treatment equalization. The sludge storage tank will be equipped with a decanter and a mixer so it can act as a small sequencing batch reactor (SBR) and treat low flows up to 50,000 gpd when one of the batch reactors can be used. The tank will also be equipped with a hydrant to haul off waste sludge or for extremely low flows act as an aerated sewage holding tank. Two aerobic digesters will be equipped to operate as batch reactors with coarse bubble aeration, mixers, and decanters. Fine bubble diffusers will not be used because the reactors will be used in Phase 1 as digesters. The Phase 1 – 1 mgd tertiary filters and UV disinfection unit will be installed. Another temporary bolted steel tank will be used as a surge tank to handle decant flows from the batch reactors.

Blowers will be housed to reduce noise. The effluent will be pumped to the rapid infiltration basins for disposal. The first phase headworks and influent and effluent pump stations will be installed. The influent pump station, headworks, batch reactors (future aerobic digesters) and sludge holding tank will be covered and have odor control using biofilters.

3.3 Phase 1.0 Plant (Figure 3)

The Phase 1 plant will have a capacity of 1 mgd. Two batch reactors will be constructed which will have fine bubble diffusers, mixers and decanters. The first phase of the permanent post equalization facility will be constructed. The headworks, influent and effluent pump stations, aerobic sludge digesters, tertiary filters, and UV disinfection were installed as part of Phase 1A. A new blower building will be built which will also house electrical control equipment. Sludge dewatering equipment (belt press or centrifuge) will be installed in a building (extension of

aerobic digester blower building). Additional biofilters will be installed to handle vented air from the new batch reactors and sludge handling areas. The temporary steel tanks will be decommissioned and removed from the site.

Section 4: 10.2 MGD Facilities and Phasing Plan

4.1 Influent Pump Station and Headworks

The planned headworks facility includes an influent pump station, totally enclosed fine screens and Pista grit removal units. These facilities will be enclosed and have odor and noise control features. Influent flows will be measured by magnetic flow meters.

The influent pump station will have a gated forebay to allow expansion and replacement of smaller pumps and piping as the plant increases in size. Pumps will be rail mounted submersible solids handling pumps.

Four trains of fine screens and grit removal equipment are anticipated to allow the orderly expansion as flows increase.

4.2 Secondary Treatment

The secondary treatment system will be phased to efficiently produce biologically stabilized and denitrified effluent as flows increase. Sequencing batch reactors (SBRs) will be used until the flows exceed 2 mgd. Fine bubble diffusers will be used to accomplish energy efficient oxygen transfer. Mixers and decanters will be installed to allow for the operation of the batch reactors. A total of four batch reactors will be constructed.

When flows approach 2 mgd two trains of MLE activated sludge plants will be constructed. Each train will consist of two new mixed anoxic tanks and three new clarifiers together with an aeration tank which was formerly a batch reactor. The two trains will be able to treat up to 4 mgd. The two other batch reactors will be used for the next 4 mgd expansion accomplished by adding two more mixed anoxic tanks and three more clarifiers.

The final expansion to 10.2 mgd will be accomplished by installing four new primary clarifiers.

The clarifiers are designed as rectangular clarifiers with belt operated scrapers and a sludge hopper. The rectangular shape will facilitate covering the tanks and odor control.

The new blowers and electrical control equipment will be installed in an expanded blower building.

4.3 Flow Equalization (Surge Basins)

Secondary effluent will discharge into flow equalization basins (surge basins) to reduce peak loading on downstream process units. The size of the units (approximately 25% of the average daily flow) will be sufficient to allow a constant flow to downstream process units thereby reducing sizes of each and simplifying operations.

While covers are not required to meet odor control requirements, covers may be included to control algae growth and preserve the secondary effluent quality prior to filtration.

4.4 Filtration Pump Station

A pump station has been included in the concept to pump secondary effluent from the surge basins to the filtration process. The pump station will provide a means of flow control and allows the filters to be installed at or above grade.

4.5 Filtration

Disk filters or traveling bridge gravity filters will be used for filtration. A series of units will be installed as flow increases up to 10.2 mgd. Odor control is not required. If open bed filters are used, a roof structure extending over the filters would be provided to reduce algae growth within the filters. Filtered effluent would flow by gravity to the disinfection process. A standby hypochlorinator will be provided to treat the filters as necessary.

4.6 Disinfection

Disinfection will be provided by ultraviolet (UV) units located in concrete channels. The UV process would avoid generation of disinfection by-products created by a chlorine disinfection process. Odor control facilities are not be required. Disinfected effluent would flow by gravity to an effluent pump station.

4.7 Effluent Pumping

Tertiary effluent would enter a wetwell outfitted with vertical turbine pumps. The basin will be sized to accommodate a future flow rate of 10.2 mgd and pump units will be added as the increase in flow warrants.

Effluent will discharge into a force main extending westerly to the proposed effluent recharge basins and may be pumped to green belt areas for irrigation. Effluent storage facilities include pumping lakes for irrigated areas. The recharge basins will be designed to store and recharge the effluent.

4.8 Operations and Maintenance Structures

Separate buildings for operations and maintenance are included in the conceptual layout. The operations building will include offices for operating staff, a locker room, rest rooms conference room and laboratory. The maintenance facility would be sized to accommodate storage of equipment and vehicles

4.9 Sludge Management

The sludge will be managed in Phase 1A (0.5 mgd) by a temporary sludge holding tank. Phase 1 will use aerobic digesters which will be expanded until flows reach 2 mgd. Additional capacity in the aerobic digesters will be accomplished by adding a thickener and additional aeration and mixing. When the primary clarifiers are added the aerobic digesters new circular aerobic digesters will be constructed and the aerobic digester tanks will be converted to other uses.

Sludge dewatering will be accomplished using centrifuges or belt presses in a building. The sludge will be treated to meet Class B requirements to allow disposal in a landfill or land application.

4.10 Phasing Summary

A table has been prepared to summarize how the plant will be modified. This table includes the interim phases from 0.5 to 10.2 mgd capacity. At this stage only a conceptual design can be developed. The overall design will be refined during the preliminary design phase which may result in some changes in the details of the phasing.

The overall goal of this report was to present a design philosophy with preliminary sizing to describe to the town the overall goal of going from batch reactors to MLE activated sludge with a final addition of primary clarifiers.

The philosophy for sludge management was also presented by starting with a temporary sludge holding tank, adding aerobic digesters, sludge thickening and dewatering equipment, and finally, anaerobic digestion.

Filtration and UV disinfection will be used in all stages.

Preliminary treatment will consist of screening and grit removal for all phases.

Effluent will meet ADEQ A+ requirements for all phases.

All treatment components will be fully enclosed with odor control. Biofilters will be used, although chemical odor control may be added for the later stages of plant development.

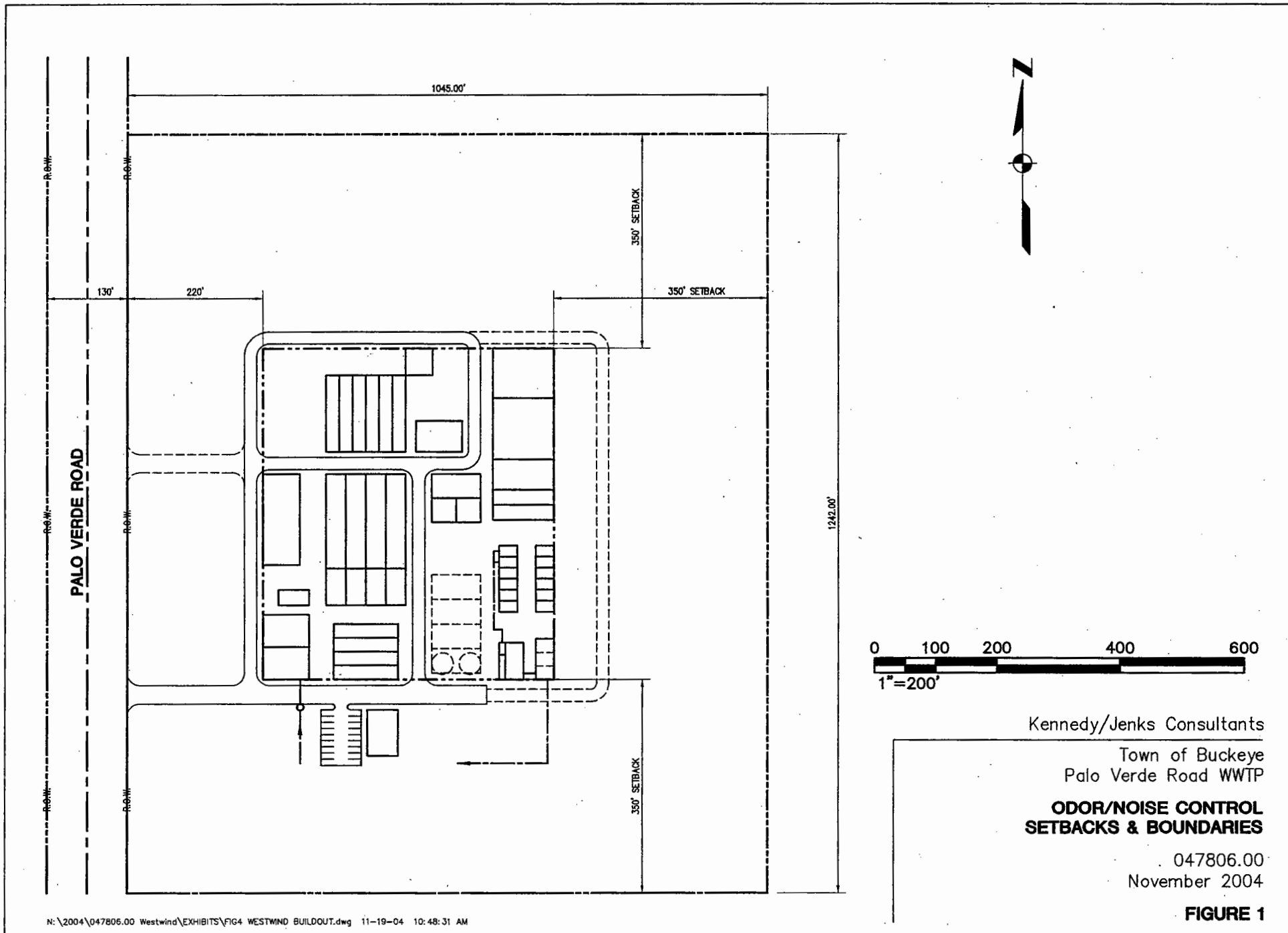
Figures 4,5,6, and 7 show the development of site for the various phases.

Table 1: Summary of Phasing

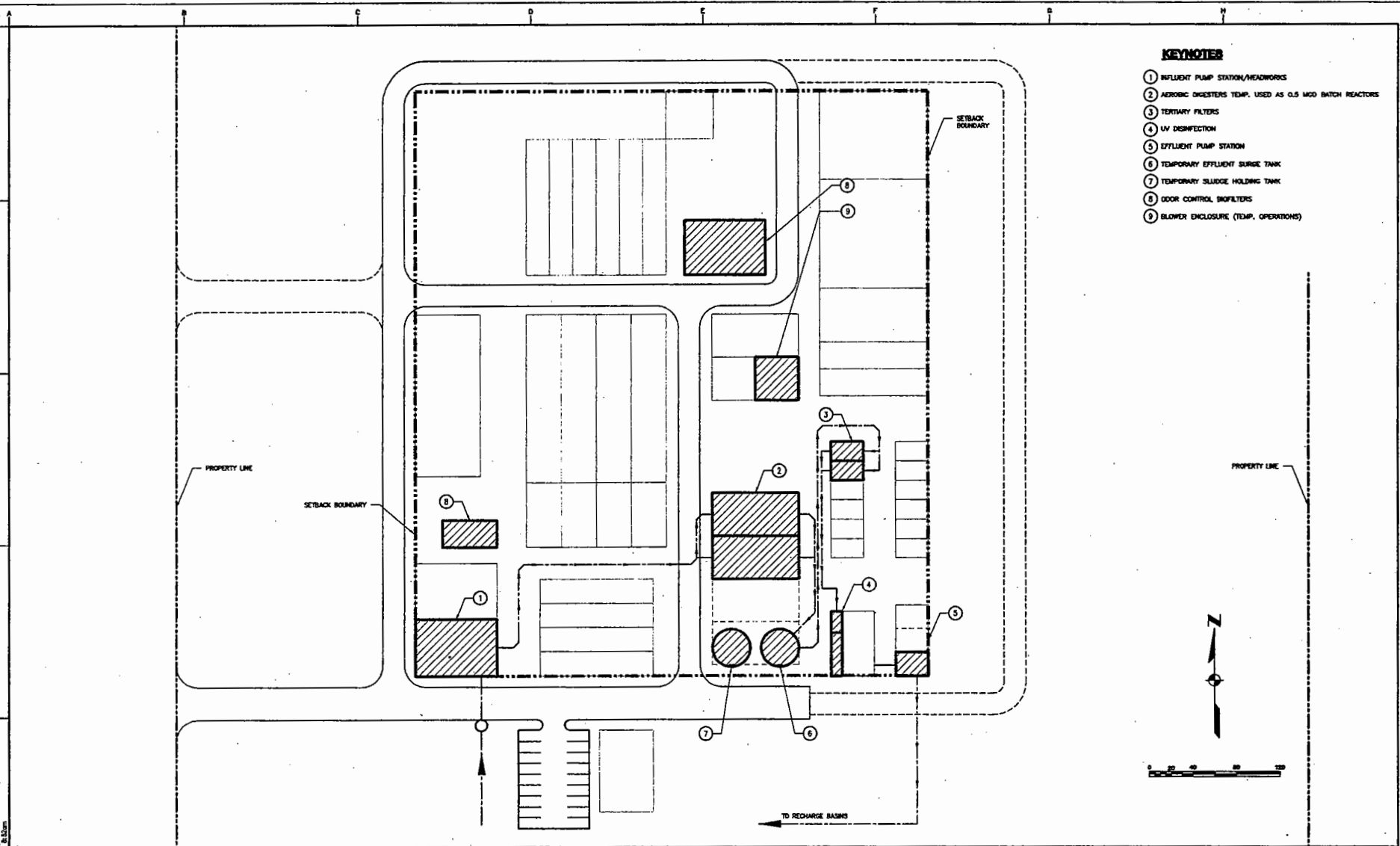
Description	Phase Ia	Phase Ib	Phase II	Phase III	Phase IV	Phase V
Capacity, mgd	0.5	1	2	4	8	10
Headworks:						
Screening	Yes	Yes	Yes	Yes	Yes	Yes
Degritting	Yes	Yes	Yes	Yes	Yes	Yes
Pumps	Yes	Yes	Yes	Yes	Yes	Yes
Primaries	No	No	No	No	No	Yes -4
SBR's	Yes -2 *a	Yes - 2	Yes - 4	Convert 2	Convert 2	No
Aeration Basins (BNR)				Yes - 2	Yes - 4	Yes -4
Secondaries	No	No	No	Yes - 3	Yes - 6	Yes - 6
Effluent Equalization	Yes	Yes	Yes	Yes	Yes	Yes
Sludge Holding	Yes	No	No	No	No	No
Thickeners	No	No	No	Yes	Yes	Yes
Digesters:						
Aerobic	Yes -2 *a	Yes - 2* b	Yes - 4	Yes - 4	No	No
Anaerobic	No	No	No	No	Yes - 2	Yes - 2

*a - Use two rectangular tanks that can be redesignated aerobic digesters @ 1.0 mgd

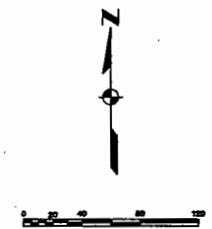
*b - Formerly the only means of biological treatment at 0.5.mgd



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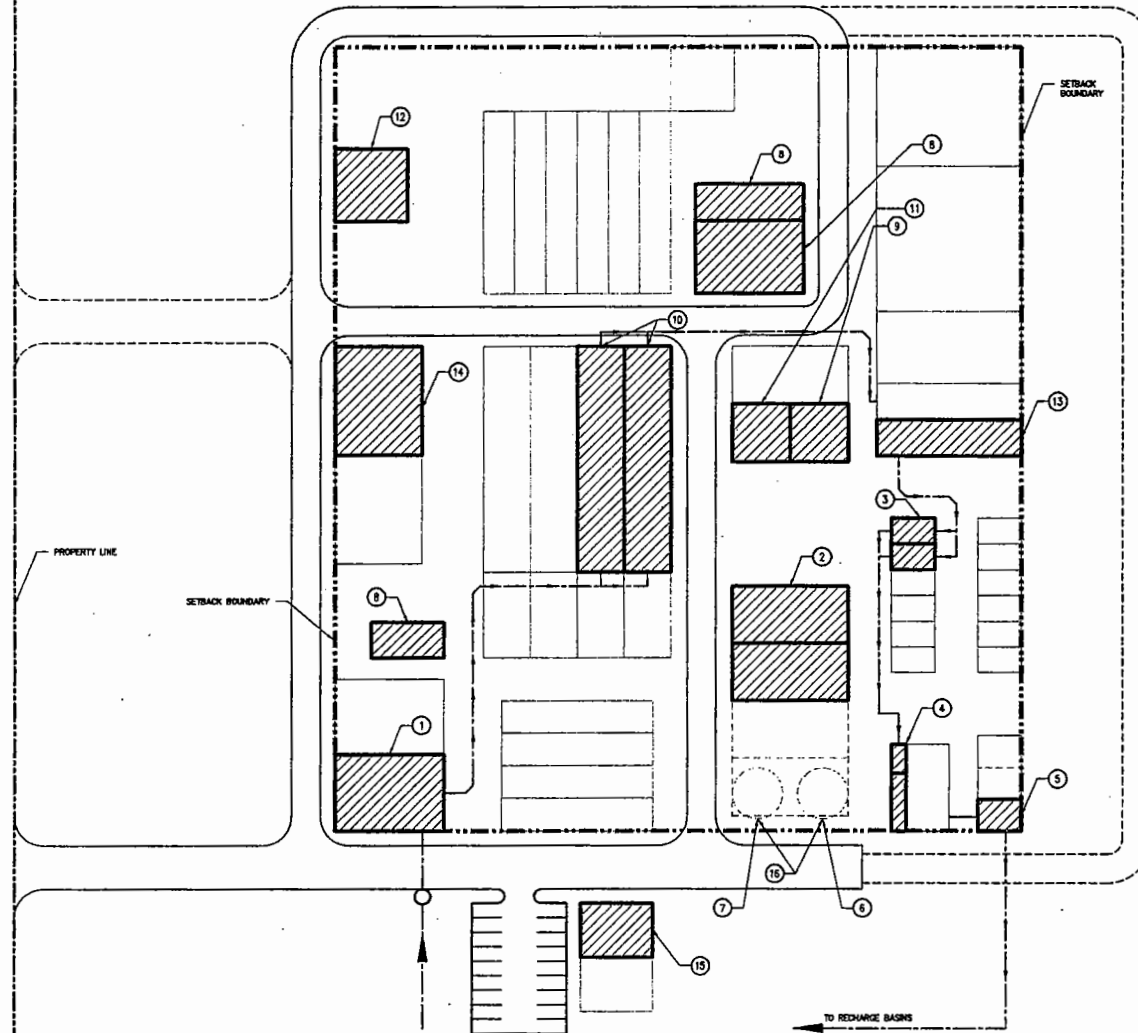
- KEYNOTES**
- ① INFLUENT PUMP STATION/HEADWORKS
 - ② AEROBIC DIGESTERS TEMP. USED AS 0.5 MGD BATCH REACTORS
 - ③ TERTIARY FILTERS
 - ④ UV DISINFECTION
 - ⑤ EFFLUENT PUMP STATION
 - ⑥ TEMPORARY EFFLUENT SURGE TANK
 - ⑦ TEMPORARY SLUDGE HOLDING TANK
 - ⑧ ODOR CONTROL BIOFILTERS
 - ⑨ BLOWER ENCLOSURE (TEMP. OPERATIONS)



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KEYNOTE

- 1 INFLUENT PUMP STATION/HEADWORKS
- 2 AEROBIC DIGESTERS
- 3 TERTIARY FILTERS
- 4 UV DISINFECTION
- 5 EFFLUENT PUMP STATION
- 6 TEMPORARY EFFLUENT SURGE TANK
- 7 TEMPORARY SLUDGE HOLDING TANK
- 8 ODOOR CONTROL BIOFILTERS
- 9 BLOWER ENCLOSURE
- 10 BATCH REACTORS
- 11 SLUDGE Dewatering EQUIPMENT
- 12 -
- 13 POST EQUALIZATION
- 14 BLOWER BUILDING
- 15 OPERATIONS BUILDING
- 16 TEMPORARY STEEL TANKS TO BE REMOVED



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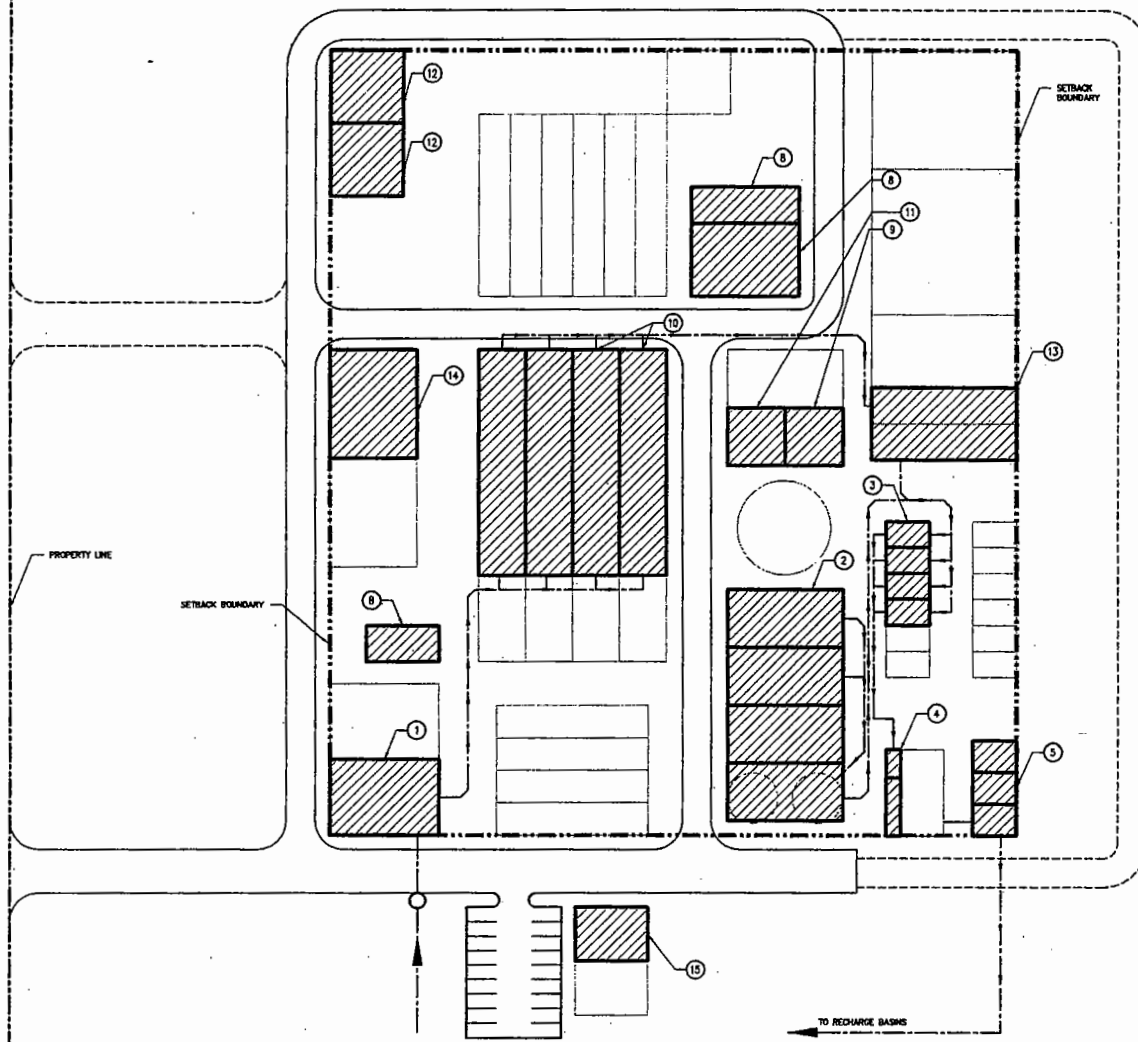
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**PALO VERDE WWTP
 PRELIMINARY LAYOUT
 10 MGD FACILITY**

DATE	NOVEMBER 2004
SHEET	3
OF	XX

KEYNOTES

- ① INFLUENT PUMP STATION/HEADWORKS
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- ⑮ OPERATIONS BUILDING



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TOWN OF BUCKEYE
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WASTEWATER TREATMENT PLANT

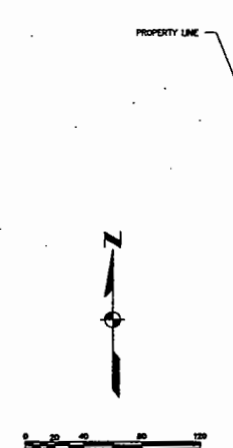
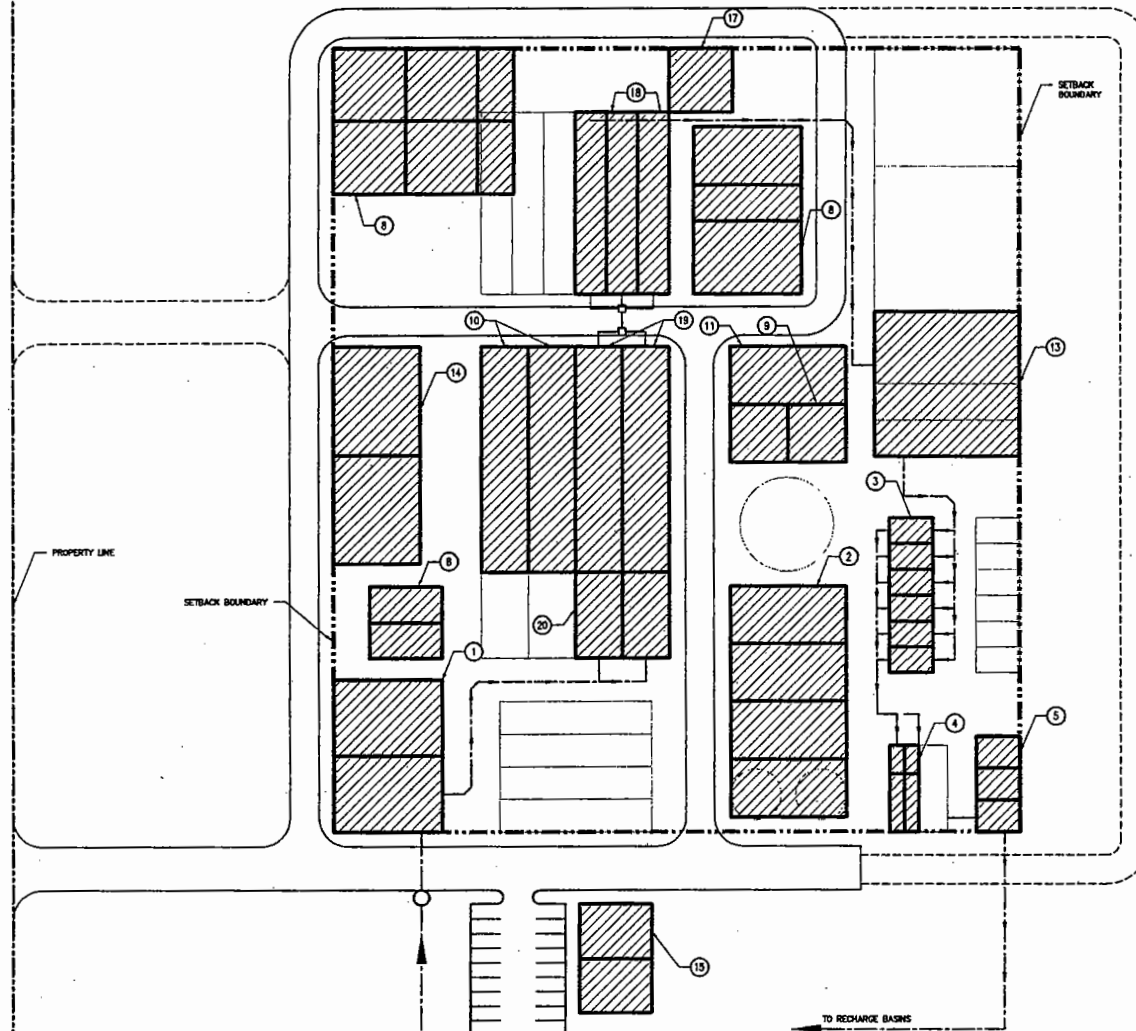
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**PALO VERDE WWTP
PRELIMINARY LAYOUT
2.0 MGD FACILITY**

DATE: NOVEMBER 2004
SHEET: 4 OF XX

KEYNOTES

- 1 INFLUENT PUMP STATION/HEADWORKS
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- 15 OPERATIONS BUILDING
- 16 -
- 17 RAS PUMP STATION
- 18 SECONDARY CLARIFIERS
- 19 AERATION TANKS
- 20 ANOXIC TANKS



PLANS AND SPECIFICATIONS FOR THE PALO VERDE WASTEWATER TREATMENT PLANT
 PROJECT NO. 047800L.00
 DATE NOVEMBER 2004
 SHEET 5 OF XX

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TOWN OF BUCKEYE
 PALO VERDE ROAD
 WASTEWATER TREATMENT PLANT

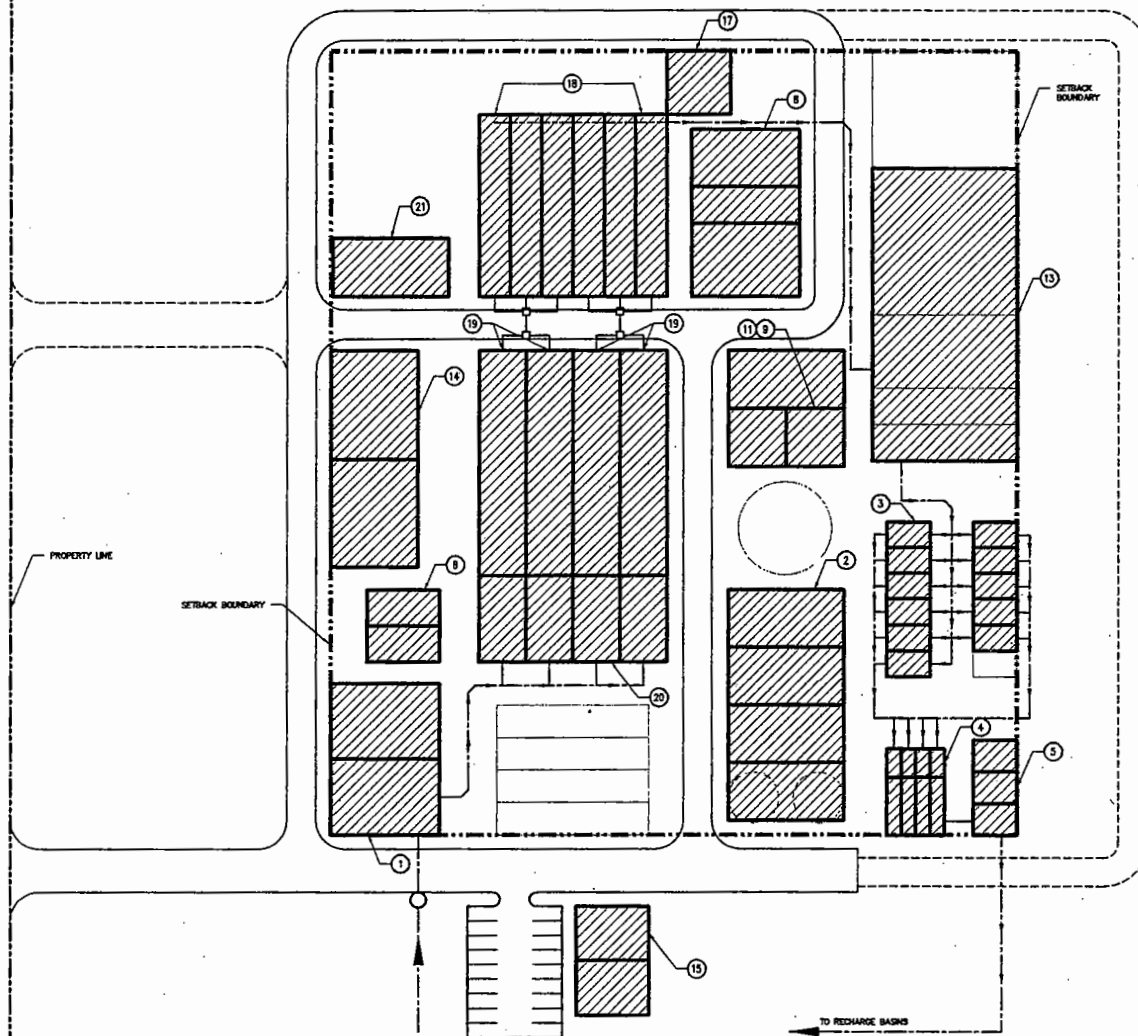
Kennedy/Jerks Consultants
 PHOENIX, ARIZONA

PALO VERDE WWTP
 PRELIMINARY LAYOUT
 4.0 MGD FACILITY

DATE	NOVEMBER 2004
PROJECT NO.	047800L.00
SHEET	5
OF	XX

KEYNOTES

- 1 INFLUENT PUMP STATION/HEADWORKS
- 2 AEROBIC DIGESTERS
- 3 TERTIARY FILTERS
- 4 UV DISINFECTION
- 5 EFFLUENT PUMP STATION
- 6 -
- 7 -
- 8 ODOR CONTROL BIOFILTERS
- 9 BLOWER ENCLOSURE
- 10 -
- 11 SLUDGE Dewatering EQUIPMENT
- 12 -
- 13 POST EQUALIZATION
- 14 BLOWER BUILDING
- 15 OPERATIONS BUILDING
- 16 -
- 17 RAS PUMP STATION
- 18 SECONDARY TANKS
- 19 AEROBIC TANKS
- 20 ANOXIC TANKS
- 21 CHEMICAL ODOR CONTROL



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NO.	REVISION	DATE	BY

SCALES

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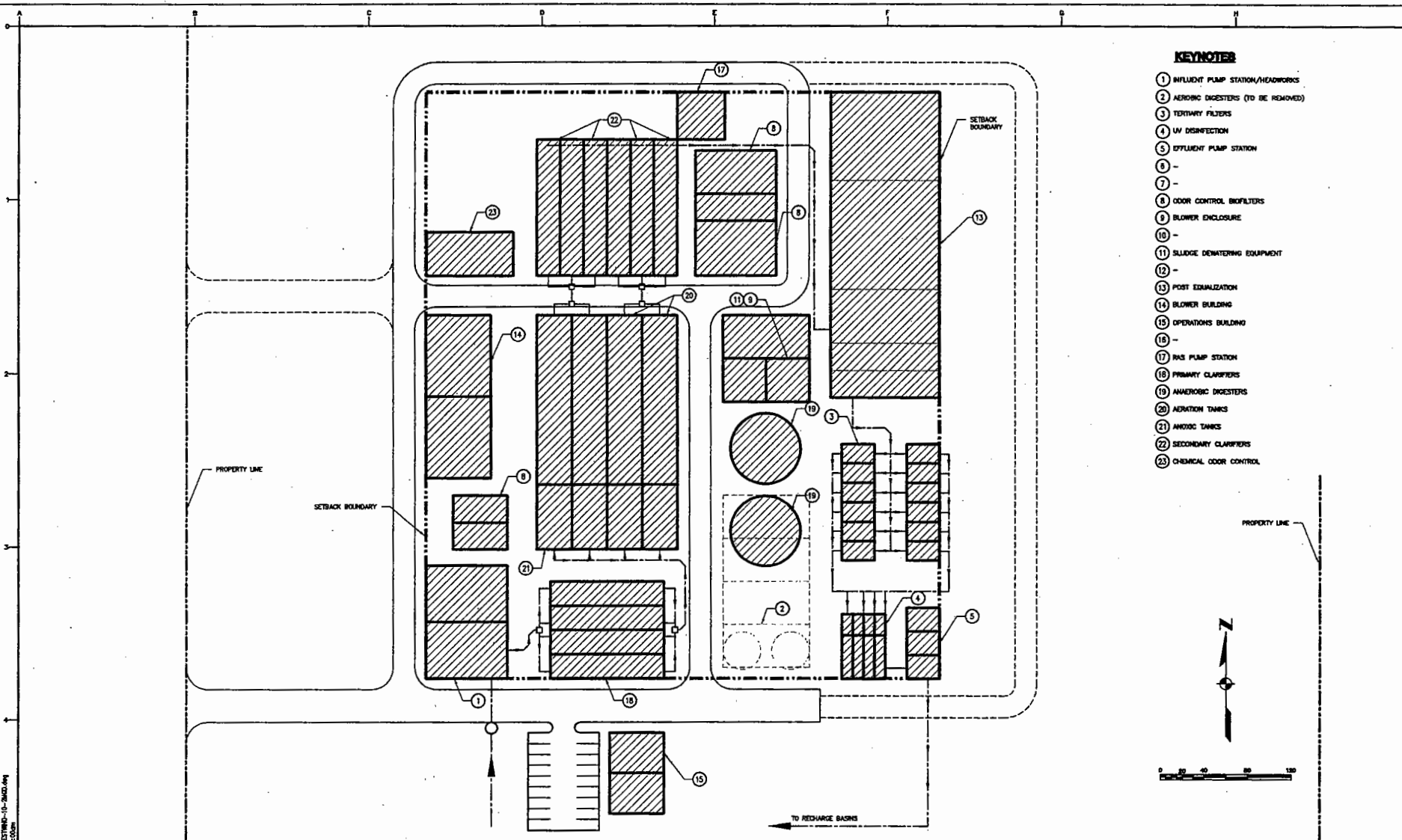
TOWN OF BUCKEYE
PALO VERDE ROAD
WASTEWATER TREATMENT PLANT

Kennedy/Jenks Consultants
PHOENIX, ARIZONA

**PALO VERDE WWTP
PRELIMINARY LAYOUT
8.0 MGD FACILITY**

DATE	NOVEMBER 2004
SHEET	6
OF	XX

ALL VERTICAL ELEVATIONS SHOWN ARE MEASUREMENTS TO THE TOP OF THE STRUCTURE UNLESS OTHERWISE NOTED.



KEYNOTES

- 1 INFLUENT PUMP STATION/HEADWORKS
- 2 AEROBIC DIGESTERS (TO BE REMOVED)
- 3 TERTIARY FILTERS
- 4 UV DISINFECTION
- 5 EFFLUENT PUMP STATION
- 6 -
- 7 -
- 8 ODOR CONTROL BIOFILTERS
- 9 BLOWER ENCLOSURE
- 10 -
- 11 SLUDGE DEWATERING EQUIPMENT
- 12 -
- 13 POST EQUALIZATION
- 14 BLOWER BUILDING
- 15 OPERATIONS BUILDING
- 16 -
- 17 RAW PUMP STATION
- 18 PRIMARY CLARIFIERS
- 19 ANAEROBIC DIGESTERS
- 20 AERATION TANKS
- 21 ANOXIC TANKS
- 22 SECONDARY CLARIFIERS
- 23 CHEMICAL ODOR CONTROL

USE OF DOCUMENTS
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NO.	REVISION	DATE	BY

SCALES
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CHECKED: FEB

TOWN OF BUCKEYE
PALO VERDE ROAD
WASTEWATER TREATMENT PLANT
Kennedy/Jenks Consultants
PHOENIX, ARIZONA

**PALO VERDE WWTP
PRELIMINARY LAYOUT
10.2 MGD FACILITY**

DATE: 04/20/00
DATE: NOVEMBER 2004
SHEET: 7 OF 10



302 North 1st Avenue, Suite 300 ▲ Phoenix, Arizona 85003
Phone (602) 254-6300 ▲ FAX (602) 254-6490
E-mail: mag@mag.maricopa.gov ▲ Web site: www.mag.maricopa.gov

December 8, 2004

TO: Interested Parties for Water Quality

FROM: Brenda Day, Environmental Planning Program Manager

SUBJECT: PUBLIC HEARING ON THE DRAFT MAG 208 WATER QUALITY MANAGEMENT PLAN AMENDMENTS FOR THE TOWN OF BUCKEYE PALO VERDE ROAD WASTEWATER TREATMENT PLANT, CITY OF SURPRISE SPECIAL PLANNING AREA 3 REGIONAL WASTEWATER TREATMENT PLANT, AND CITY OF GLENDALE TEMPORARY SEWER SERVICE AGREEMENT AND FUTURE WATER RECLAMATION PLANT CORRECTION

Public Hearing

January 19, 2005 at 4:00 p.m.
MAG Office, Saguaro Room
302 N. 1st Avenue, Second Floor
Phoenix, Arizona 85003

The Maricopa Association of Governments (MAG) will conduct a public hearing on the Draft MAG 208 Water Quality Management Plan Amendments for the Town of Buckeye Palo Verde Road Wastewater Treatment Plant, City of Surprise Special Planning Area 3 Regional Wastewater Treatment Plant, and City of Glendale Temporary Sewer Service Agreement and Future Water Reclamation Plant Correction on January 19, 2005. The purpose of the hearing is to receive public comments on the draft plan amendments.

The proposed Buckeye Palo Verde plant would have a capacity of 10.2 million gallons per day (mgd) and would be located east of Palo Verde Road, between Broadway and Southern. Reclaimed effluent would be disposed through reuse, recharge, and an Arizona Pollutant Discharge Elimination System (AZPDES) permit discharge. The City of Surprise Special Planning Area 3 plant would have a 30 mgd capacity and would be located in the southwest quarter of Section 22 of Township 4 North, Range 2 West. Reclaimed effluent would be disposed through reuse, recharge and an AZPDES permit discharge.

The draft Glendale amendment defines an area within the Glendale Municipal Planning Area where temporary sewer service will be provided by the City of Surprise, and includes a correction to the 208 Plan to delete a future Arizona American Water Company Water Reclamation Plant with an ultimate capacity of 8.0 mgd and sewer service area within the western portion of the Glendale Municipal Planning Area.

For your information and convenience, a copy of the public hearing notice is enclosed. The draft documents

are available for public review at the MAG Office, third floor from 8:00 a.m. to 5:00 p.m. Monday through Friday. Copies are also available for review at the Glendale Public Library, 5959 West Brown Street; Mesa Public Library, 64 East First Street; and Phoenix Central Public Library, 1221 North Central Avenue. Public comments are welcome at the hearing, or may be submitted in writing by 4:00 p.m. on January 19, 2005 to MAG staff at the address below.

Contact Persons: Brenda Day- Buckeye and
Surprise Amendments
Julie Hoffman- Glendale
Amendment
302 N. 1st Avenue, Suite 300
Phoenix, AZ 85003
Fax: (602) 254-6490

**PUBLIC HEARING ON THE DRAFT MAG 208 WATER QUALITY MANAGEMENT PLAN
AMENDMENTS FOR THE CITY OF SURPRISE SPECIAL PLANNING AREA 3 REGIONAL
WASTEWATER TREATMENT PLANT, TOWN OF BUCKEYE PALO VERDE ROAD
WASTEWATER TREATMENT PLANT AND CITY OF GLENDALE TEMPORARY SEWER
SERVICE AGREEMENT AND FUTURE WATER RECLAMATION PLANT CORRECTION**

Wednesday, January 19, 2005 at 4:00 p.m.
MAG Office, Suite 200 - Saguaro Room
302 North 1st Avenue
Phoenix, Arizona 85003

The Maricopa Association of Governments (MAG) will conduct a public hearing on the Draft MAG 208 Plan Amendments for the Town of Buckeye Palo Verde Road Wastewater Treatment Plant, the City of Surprise Special Planning Area 3 Regional Wastewater Treatment Plant, and the City of Glendale Temporary Sewer Service Agreement and Future Water Reclamation Plant Correction. The purpose of the hearing is to receive public comments on the draft amendments.

The proposed Surprise Special Area 3 Plant would have a capacity of 30 million gallons per day (mgd) and would be located in the southwest quarter of Section 22 of Township 4 North, Range 2 West. Reclaimed effluent would be disposed through reuse, recharge and an Arizona Pollutant Discharge Elimination System (AZPDES) permit discharge. The proposed Buckeye Palo Verde Plant would have a capacity of 10.2 mgd and would be located east of Palo Verde Road, between Broadway and Southern. Reclaimed effluent would be disposed through reuse, recharge, and an AZPDES permit discharge.

The Glendale amendment defines an area within the Glendale Municipal Planning Area where temporary sewer service will be provided by the City of Surprise, and includes a correction to the 208 Plan to delete a future Arizona American Water Company Water Reclamation Plant with an ultimate capacity of eight million gallons per day and sewer service area within the western portion of the Glendale Municipal Planning Area.

Following consideration of comments received, it is anticipated that the MAG Water Quality Advisory Committee will make a recommendation to the MAG Management Committee. On February 9, 2005, the MAG Management Committee is anticipated to make a recommendation to the MAG Regional Council. It is anticipated that the MAG Regional Council will take action on the draft plan amendments on February 23, 2005.

The draft documents will be available for public review at the MAG Office from 8:00 a.m. to 5:00 p.m. Monday through Friday beginning Wednesday, December 8, 2004. Copies will also be available for review at the Glendale Public Library, 5959 West Brown Street; Mesa Public Library, 64 East First Street; and Phoenix Central Public Library, 1221 North Central Avenue. Public comments are welcome at the hearing, or may be submitted in writing by 4:00 p.m. on January 19, 2005 to MAG staff at the address below.

Contact Persons: Brenda Day- Buckeye and
Surprise Amendments
Julie Hoffman- Glendale
Amendment
302 N. 1st Avenue, Suite 300
Phoenix, AZ 85003
Fax: (602) 254-6490

Maricopa Association of Governments
Phoenix

JAN 28 2005

MARICOPA ASSOCIATION OF GOVERNMENTS
WATER QUALITY ADVISORY COMMITTEE MEETING
AND PUBLIC HEARING
ON THE DRAFT MAG 208 PLAN AMENDMENT
FOR THE CITY OF SURPRISE SPA III,
TOWN OF BUCKEYE PALO VERDE ROAD
WASTEWATER TREATMENT FACILITY, AND
CITY OF GLENDALE TEMPORARY SEWER SERVICE AGREEMENT AND
FUTURE WATER RECLAMATION PLAN CORRECTION

January 19, 2005
4:06 p.m.
Phoenix, Arizona

Glennie
Reporting Services

5333 North 7th Street
Suite B110
Phoenix, Arizona 85014-2840

(602) 266-6535 Phone
(602) 266-9661 Fax

Prepared by:
Dawna J. Boswell, RPR
Arizona Certified Court
Reporter No. 50326

Prepared for:

(Original)

1 The Public Hearing was taken on January 19,
2 2005, commencing at 4:06 p.m., at the offices of the
3 Maricopa Association of Governments, 302 North First
4 Avenue, Suite 200, Saguaro Room, Phoenix, Arizona, before
5 DAWNA J. BOSWELL, a Certified Court Reporter, Certificate
6 No. 50326, for the State of Arizona.

7 Mr. Roger Klinger for the City of Scottsdale
8 acted as the Chairman.

9 Members attending were Greg Stack, City of
10 Avondale; Lucky Roberts, City of El Mirage; Chris Ochs,
11 City of Glendale; Barry Hess, City of Goodyear; Robert
12 Hollander, City of Phoenix; Rich Williams, City of
13 Surprise; Dale Bodiya, Maricopa County; John Boyer,
14 Pinnacle West Capital; Patrick Clay, University of
15 Arizona Cooperative Extension; Jacqueline Strong, City of
16 Chandler (via conference call); Lonnie Frost, Town of
17 Gilbert (via conference call); Bill Haney, City of Mesa
18 (via conference call); Steven Bontrager, City of Peoria
19 (via conference call).

20 Also present were Mayor Fred Waterman, B.J.
21 Cornwall, and Joanne Garrett, City of El Mirage; Raj
22 Thakur and Kevin Elverum, RT Engineers; George Shirley,
23 Carollo Engineers; Ken Reedy, Roger Baily and Glenn
24 Compton, City of Glendale; Chris Young, Town of Buckeye;
25 Tim Goodrich, Maracay Homes; Jared Carr and Brandon

1 Squire, RBF Consulting; Fred Goldman, Kennedy/Jenks;
2 Brenda Day, Julie Hoffman, and Stephen Gross, Maricopa
3 Association of Governments.
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11 The following proceedings were had:
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1 MR. KLINGER: I'd like to call the meeting
2 to order.

3 First, a reminder to please speak directly
4 into the microphone so that the members attending by
5 audio/videoconference can hear you, and I would also like
6 to ask the folks who are speaking on audiophone to please
7 use your receiver, not your speaker phone so we can hear
8 you better.

9 And let's begin with our committee member
10 introductions starting with those attending by
11 audioconference. Bill, can you hear me?

12 MR. HANEY: Yes, I can. Bill Haney, City of
13 Mesa.

14 THE COURT REPORTER: I didn't hear his name.

15 MR. KLINGER: Bill Haney from the City of
16 Mesa.

17 Lonnie, are you with us? No.

18 Jacqueline.

19 MS. STRONG: Yes.

20 MR. KLINGER: Could you state your name and
21 city for the record.

22 MS. STRONG: Jacqueline Strong, Chandler.

23 MR. KLINGER: We're having trouble hearing.

24 MS. STRONG: Jacqueline Strong from
25 Chandler, okay?

1 MR. KLINGER: We are having a little trouble
2 hearing you, so if you would both speak up, we would
3 appreciate it.

4 Let's start with John and go around and
5 introduce ourselves.

6 MR. BOYER: I'm John Boyer with Arizona
7 Public Service Company.

8 MR. CLAY: Patrick Clay with the University
9 of Arizona Cooperative Extension.

10 MS. ROBERTS: Lucky Roberts, City of
11 El Mirage Public Works.

12 MR. OCHS: Chris Ochs, City of Glendale.

13 MR. KLINGER: Roger Clinger, City of
14 Scottsdale.

15 MR. HOLLANDER: Bob Hollander, City of
16 Phoenix.

17 MR. STACK: Greg Stack, City of Avondale.

18 MR. HESS: Barry Hess, City of Goodyear.

19 MR. WILLIAMS: Rich Williams, City of
20 Surprise.

21 MR. KLINGER: Okay. We do have a quorum.

22 We also have a time on our agenda when
23 member agencies can report on activities of interest
24 occurring in their agencies. I don't want to ask if
25 anyone is doing anything interesting, but do you have

1 anything to report on of interest? I'm sure everyone is
2 doing interesting work, but anything compelling at this
3 point?

4 MR. BONTRAGER: Roger?

5 MR. KLINGER: Yes.

6 MR. BONTRAGER: This is Steven Bontrager
7 with the City of Peoria also on the telephone.

8 MR. KLINGER: Okay, Steven Bontrager, City
9 of Peoria. Thanks, Steven. Thank you for joining us.

10 Okay. Let's go to item 3 is our call to the
11 audience which is an opportunity for citizens to comment
12 on items not scheduled on today's agenda that fall under
13 the jurisdiction of MAG or on items on the agenda that
14 are for discussion but not for action. This is the only
15 opportunity to comment on nonaction items. Because of
16 state law, the committee may not discuss or take action
17 on any items not scheduled on the agenda. For members of
18 the audience who wish to speak, cards are available from
19 staff. Please fill out a blue card and give it to
20 Brenda.

21 Did we get any?

22 MS. DAY: No.

23 MR. KLINGER: Okay. Seeing none, then we
24 will move on to the next item, the approval of our
25 November 30, 2004 meeting minutes. The minutes are

1 included in your packet for your review. Are there any
2 corrections or additions to the minutes? Any other
3 questions on the minutes? If not, I would accept a
4 motion.

5 MR. HOLLANDER: I do have a question. On
6 page 4 at the top, there is a statement I guess made by
7 Mr. Williams on page 4 of the meeting minutes. It states
8 that Mr. Williams indicated that a wash goes through the
9 site, although it is not a water of the United States. I
10 wanted to check to see if that is correct.

11 Let me restate it again. On page 4 of the
12 meeting minutes, it states, "Mr. Williams indicated that
13 wash goes through the site, although it is not a water of
14 the United States." I just wanted to make sure that that
15 was accurate.

16 MR. WILLIAMS: Possibly I wasn't using the
17 correct reference or terminology. The intent was that
18 the Army Corps of Engineers has responded the wash does
19 not include waters of the United States, and a 404 permit
20 is not required. And we have a letter on record to that
21 effect.

22 MR. HOLLANDER: Okay.

23 MR. KLINGER: All right. Sorry about the
24 problems. We'll work it out.

25 Any other questions, comments? If not, I'll

1 accept a motion for approval.

2 MR. HESS: I move that we approve the
3 minutes.

4 MR. KLINGER: Hearing a motion, is there a
5 second?

6 MR. OCHS: Second.

7 MR. KLINGER: Any further discussion? All
8 in favor, please say aye.

9 (A chorus of ayes.)

10 MR. KLINGER: Opposed, nay.

11 (No response)

12 MR. KLINGER: Motion carries unanimously.

13 Thank you.

14 Let's move to the next item on the agenda,
15 the public hearing. The public hearing is now open on
16 the Draft MAG 208 Plan Amendment for the Surprise Special
17 Planning Area III called SPA III, the Town of Buckeye
18 Palo Verde Road Wastewater Treatment Facility, and the
19 City of Glendale Temporary Sewer Service Agreement and
20 Future Water Reclamation Plan correction.

21 We begin with a briefing on each draft
22 amendment. Following the briefings, hearing participants
23 are invited to make comments for the public record. We
24 do have a court reporter present to provide an official
25 record of the hearing. Again, I would ask that we speak

1 into the microphone so the court reporter, or the
2 official recorder can get all the comments down. Any
3 written comments from the public are also welcome.

4 Those who wish to speak on the amendments,
5 we have a yellow card that can be filled out and given to
6 Brenda, and she will hand it to me, and we will call on
7 any member of the public.

8 What we're going to do is we're going to
9 have the three items on the amendment on the agenda here,
10 and we're going to have a briefing on each, and then
11 we'll have public comment, and then we will have another,
12 we have action items for each of those for further
13 discussion by the committee. In general, we'll have the
14 questions when we have that discussion by the committee,
15 but if there's something you are afraid you might forget,
16 you know, until later, it's okay to ask a question right
17 after each briefing. These are all items we discussed in
18 the November meeting, so I think we had pretty thorough
19 discussion and a lot of questions and answers then. But
20 if there's something else, go ahead and ask, and we'll go
21 through and have the briefing to remind us of what was
22 taking place then.

23 I guess first we will do the Surprise SPA.
24 Rich, you're going to introduce Raj for this?

25 MR. WILLIAMS: Yes.

1 MR. KLINGER: Thank you.

2 MR. WILLIAMS: Rich Williams, City of
3 Surprise, and we'll keep it brief. We've had the
4 presentation before, and I just wanted to emphasize that
5 the application is the city's application, and we're
6 partnering with developers, but it's not developer
7 driven, it's city driven. So I would like to introduce
8 Raj Thakur with RT Engineering.

9 MR. THAKUR: Thanks, Rich.

10 Good afternoon, ladies and gentlemen. This
11 is the MAG 208 Amendment presentation for the City of
12 Surprise, Special Planning Area 3, Water Reclamation
13 Facility. The objective of the MAG 208 Amendment is to
14 request a Clean Water MAG 208 Amendment to the original
15 Water Quality Management Plan to accommodate an ultimate
16 build-out 30 MGD Regional Water Reclamation Facility in
17 the City of Surprise Special Planning Area 3.

18 The city's entire planning area is divided
19 into six special planning areas designated as SPA 1
20 through SPA 6, and in Figure 1, the different, all the
21 six planning areas are shown with color coding. The
22 Special Planning Area 3 is the one with the light gray,
23 and the boundaries are Central Arizona Project Canal, the
24 Beardsley Canal, and Grand Avenue.

25 Currently, there is no wastewater collection

1 and treatment facilities in the Surprise Special Planning
2 Area 3. The city has completed an Integrated Water
3 Master Plan which has identified the collection and
4 wastewater treatment needs for the six special planning
5 areas for the next 20 years.

6 The City of Surprise has also completed and
7 adopted the General Plan 2020 which provides a
8 comprehensive development guide for the six planning
9 areas. In addition, the city has hired a consultant to
10 prepare a Technology Assessment Report which will
11 identify the wastewater treatment technologies for the
12 water reclamation facilities in all the six special
13 planning areas.

14 The driving force for the proposed Special
15 Planning Area 3 Phase 1 Water Reclamation Facility is the
16 development of a national planned community subdivision
17 known as Austin Ranch by Courtland Homes. The city and
18 Courtland Homes are working with Rio Rancho Development
19 to achieve a joint effort for the Austin Ranch and Rio
20 Rancho development. Recently, the Rio Rancho development
21 has reached a Memorandum of Understanding with the City
22 of Surprise.

23 The ultimate build-out capacity of the plant
24 is 30 MGD, and approximately 140 acres of land is
25 available for the planned construction. The city plans

1 to build the 30 MGD water reclamation facility in
2 multiple phases. The first phase will be designated as
3 Developer Phase 1 with the capacity of 1.8 MGD. The
4 subsequent phases from Phase 2 to build out will be
5 designated as city's master planned phases.

6 Figure 2 represents the location of the
7 water reclamation facility. This square box in here is
8 the proposed site for the water reclamation facility
9 which is approximately a half mile south of the Deer
10 Valley Road, and the, and west of 183rd Avenue.

11 Figure 3 provides the conceptual layout for
12 the Phase 1 infrastructure and also the master planning
13 for the Phase 2 up to the ultimate build out. As you can
14 see, here on the southeast corner is the infrastructure
15 for the Phase 1A which is 1.8 MGD, and then the recharge
16 basins and this area here is designated for the future
17 expansions.

18 The city envisions the future design of the
19 subsequent phases from Phase 2 to build out in multiple
20 modular-type treatment facilities at future dates. The
21 developer Phase 1 1.8 MGD water reclamation facility is
22 proposed to be constructed in three subphases designated
23 as Phase 1A, B and C each with a capacity of 600,000
24 gallons per day. The developer Phase 1 1.8 MGD water
25 reclamation facility, the unit processes that will be

1 used to obtain the required water quality are shown here,
2 the headworks followed by secondary treatment, biological
3 treatment, nitrification, denitrification, clarification,
4 filtration, disinfection, effluent disposal, and solids
5 handling. The permits, the SPA 3 will produce Class A
6 effluent per ADEQ Title 18 requirements which has the
7 turbidity and total nitrogen requirements shown here.
8 The dewatered sludge will be Class B type, and the
9 effluent will be disposed of via on-site recharge.

10 The permits for the SPA 3 Phase I Water
11 Reclamation Facility will be as follows: The Aquifer
12 Protection Permit from ADEQ, Approval to Construct by
13 Maricopa County, Approval of Construction by Maricopa
14 County, Vault and Haul Operation Permit by Maricopa
15 County and obtained by the City of Surprise, Groundwater
16 Recharge and Recovery Permits, Air Quality Permits, and
17 the Arizona PDES Permit and the Annual Operations Permit
18 which is issued by Maricopa County.

19 The schedule for the design and construction
20 is the Developer Phase 1A of 600,000 gallons per day is
21 scheduled for construction by mid-year 2005 and will be
22 in operation by July 2006. Once the facility is approved
23 by the Maricopa County and is in operation, the ownership
24 and operation responsibilities will be transferred to the
25 City of Surprise. The City of Surprise will be the

1 applicant for the permits, all permits, obtain all
2 applicable permits, obtain Vault and Haul Permits, and
3 will finance the design, construction, and operation of
4 the water reclamation facility through development impact
5 fees in conjunction with the City of Surprise capital
6 improvement bonds and sewer development fees.

7 That's the end. Are there any questions?

8 MR. KLINGER: Thank you, Raj. Are there any
9 questions at this point that can't wait until we have the
10 item on the agenda? If not, we may come back, Raj, but
11 right now, we will go to the next presentation. Thank
12 you.

13 MR. THAKUR: Thank you.

14 MR. KLINGER: Our next item is the Palo
15 Verde Treatment Facility. I think Brandon Squire from
16 RBF is going to present. Brandon.

17 MR. SQUIRE: My name is Brandon Squire with
18 RBF Consulting. I represent a private development out in
19 the Town of Buckeye. This development is approximately
20 660 acres in Buckeye. It's the Westwind, it's a
21 master-planned community.

22 As we went forward with this project in
23 working with the town, there are no services currently in
24 this area for wastewater in the Town of Buckeye. We
25 worked with the town, and an adjacent property, the

1 SilverRock development, is an additional master-planned
2 community in the area, and then worked with the town to
3 outline the parcel area that would be served by this
4 treatment plant. We looked at the location of the
5 treatment plant here on Palo Verde Road, approximately
6 one-half mile south of Broadway, and as part of this
7 project, there is also a recharge area along the
8 Hassayampa River to recharge the effluent.

9 As part of our initial development, the West
10 Park Project, like I said, is approximately 650 acres.
11 That project will have a flow, an average daily flow of
12 approximately 1.1 million gallons a day.

13 The adjacent property, the SilverRock
14 development, is again about 1,300, 1,340 acres, with a
15 flow of 2.2 million gallons a day. For the total service
16 area including the out parcels, we're looking at a total
17 area of about 6,640 as you can see here acres, and the
18 ultimate build-out flow of 10.2 million gallons to the
19 flow into this.

20 MR. KLINGER: Brandon, real quick on the
21 SilverRock, is that twice as dense as Westwind or what's
22 the planning there?

23 MR. SQUIRE: Yes, it has a higher density in
24 it is what it is.

25 In looking at all of the permit

1 requirements, this facility will be owned and operated by
2 the town. The town will take ownership, the Town of
3 Buckeye will take ownership of the facility before it
4 goes into operation. They will be the permit holder for
5 all of the permits that are required for the facility.
6 All of these permits are currently in the process of
7 beginning on or are in the process to gain these permits.
8 Again, the town will be the holder of all permits for the
9 facility itself.

10 At this time, I will turn some time over to
11 Fred Goldman from Kennedy/Jenks to talk about the plant
12 itself.

13 MR. GOLDMAN: Thank you, Mr. Chairman.

14 I'm going to go to the second slide which
15 basically shows the build out of the 10.2 million gallon
16 per day plant. The plant will be constructed in phases.
17 The first phase will actually be two batch reactors, the
18 0.5 million gallon per day batch reactors, which will
19 produce an A plus effluent. It will have biological
20 nitrogen removal. The effluent will be filtered in these
21 first filters and disinfected using UV disinfection, and
22 will then go to recharge or may be used for reuse on the
23 site.

24 The second phase would be one million
25 gallons per day, and it's these two units. These two

1 units would actually be batch reactors, but have fine
2 bubble diffusers.

3 The next phase would be to add two more
4 units to bring the capacity up to 2 million gallons per
5 day, increasing the other facilities such as the filters,
6 UV disinfection, and also the aerobic digesters. We
7 would then proceed to begin to convert these batch
8 reactors into actual, what we call the MLE process by
9 adding these two tanks which would be anoxic mix tanks
10 for nitrogen removal, and we would have internal recycle
11 between these aeration tanks and the anoxic tanks. We
12 would also add clarifiers. So by that, we would increase
13 the process to 4 million gallons per day, do the same
14 here with these two tanks by adding anoxic tanks and more
15 clarifiers to get up to 8 million gallons per day.

16 All the tanks would be covered, all of the
17 facility would have odor control, and eventually,
18 finally, to get to 10.2 MGD, we would add these primary
19 clarifiers in front. The project would have mechanical
20 sludge dewatering, and the sludge would be treated to a
21 Class B that could be used for land application or
22 dewatered to be used at a landfill. Ultimately, for
23 energy purposes, there is accommodation in the future if
24 there is a need to convert the aerobic digesters to
25 anaerobic because a plant larger than 5 MGD could

1 generate sufficient methane to be used as an energy
2 source, perhaps partnering with the energy company. So
3 that's why this final phase has these two circles here.

4 These are equalization tanks which are
5 required to optimize the filtration and UV, and there's
6 additional blower buildings, an administrative building,
7 and the headworks pump station is in this general area.
8 The purpose is to provide a clear effluent that would be
9 suitable for direct recharge. Actually, this would have
10 recharge basins with an effluent that meets aquifer water
11 quality standards.

12 MR. KLINGER: Thank you, Fred. Are there
13 any questions at this point? All right.

14 Brandon, did you have anything else at this
15 point?

16 MR. SQUIRE: No.

17 MR. KLINGER: Hang loose. We may have some
18 when we get to that item later.

19 Okay, we will move to the next item, the
20 Glendale 208 Amendment, and George Shirley will be
21 presenting that.

22 MR. SHIRLEY: Good afternoon.

23 The Glendale amendment contains two
24 elements: A Temporary Sewer Service Agreement with the
25 City of Surprise, and the second item will be the future

1 water reclamation plant correction item.

2 The area involved is the Cortez and White
3 Tank Foothills area. The previous slide mentioned an
4 Intergovernmental Agreement. The two cities have
5 executed that agreement, and it's in effect, and there's,
6 the City of Surprise has an agreement with the
7 developers, I believe, a will serve letter.

8 One question was raised regarding sewer
9 service in this entire area last, at the last meeting,
10 and the City of Glendale is currently reviewing their
11 options as to what they will do permanently with the
12 strip annexed area largely.

13 There was also a question raised relative to
14 who would be doing the maintenance and operation of the
15 sewer system, and there was a letter that was replaced
16 and corrected in the package having to do with clarifying
17 that the City of Surprise will be responsible for
18 operation and maintenance of the sewer system. I believe
19 a replacement letter has been distributed.

20 Moving on to the next item, in the current
21 Water Quality Management Plan, there is an item for a
22 water reclamation plant that was proposed by the Arizona
23 American Water Company in late 2001. The City of
24 Glendale, however, never considered that planning item,
25 and it was incorrectly placed into the 208 Plan. The

1 purpose of this item is to make correction and delete
2 that future 8 MGD plant and sewer service area in the
3 western portion of the Glendale Planning Area. The
4 location of that plant was right here, and their planning
5 area was in conjunction with the Russell Ranch in this
6 area right here. Here's a blow-up of that.

7 The text will be revised in the 208 Plan to
8 delete the paragraphs that reference "within the western
9 portion of the Glendale Planning Area." Arizona American
10 Water Company is planning a sewer service for the area
11 called the Arizona American Water Company Service Area.
12 The definition of the location, that will be struck. The
13 second part talked about their evaluating options and
14 what the plant was going to be, what it would contain.
15 Those paragraphs will be struck from the plan. In
16 addition, in the executive summary, the tabulation will
17 also be corrected to delete reference to that plant. It
18 was going to be a .5 MGD initially and expand to 8, and
19 had a cost of 3 million. There were some figures that
20 will also be corrected in the plan.

21 For both of these items, the City of
22 Glendale sought letters of no objection or letters of
23 support, and they received letters from each entity that
24 was within the required distance from the site, and we
25 used this figure to ascertain who was within the required

1 distance.

2 Are there any questions?

3 MR. KLINGER: Any questions at this point
4 for George? Okay. Thanks, George.

5 At this time, we're going to move to our
6 public comment portion. Public comments are invited on
7 each of the Draft Plan 208 amendments. Brenda, did we
8 get any cards for anyone to speak? If you want to,
9 there's a yellow card to fill out.

10 MS. DAY: They're by the front, if anybody
11 would like to fill one out, but no, we don't have any at
12 this time.

13 MR. KLINGER: Okay. We don't have any
14 cards. Then let's declare the public hearing closed, and
15 request that the court reporter end the transcription.

16 (The public hearing portion of the
17 proceedings adjourned at 4:35 p.m.)

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1 STATE OF ARIZONA)
2) ss.
3 COUNTY OF MARICOPA)
4

5 I, DAWNA J. BOSWELL, Certified Court Reporter
6 No. 50326 for the State of Arizona, do hereby certify
7 that the foregoing printed pages constitute a full, true
8 and accurate transcript of the proceedings had in the
9 foregoing matter, all done to the best of my skill and
10 ability.

11 WITNESS my hand this 27th day of January,
12 2005.
13
14

15 _____
16 Dawna J. Boswell, RPR
17 Arizona Certified
18 Court Reporter No. 50326
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